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JAPAN

MONETARY POLICY AND ECONOMIC PROJECTIONS

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* Changes in, Development of Economy in 90's

902A0103A Tokyo SEIJI TO KEIZAI in Japanese Jan 90 pp 30-35

[Article by economic journalist, Akio Iwabuchi]

[Text] With the beginning of the Heisei era (1989), various new industries connected to "knowledge and the mind" have raised their heads and that tendency probably will grow in 1990. Gloom can be seen in the electronics industry and housing construction which have been driving domestic prosperity and signs of sluggish demand in the auto industry have appeared in the United States. The economy has changed from clear to cloudy skies. Amidst this, trade friction centering on U.S.-Japanese relations has become acute and controlled tradeism seems to be increasing in strength. It is presumed that M&A (company mergers and acquisitions) also will become more active for survival.

End of Industrial Society

In 1989, the Japanese economy was in good condition supported by flourishing domestic demand though it embraced many problems such as deepening U.S.-Japanese trade friction. It is a fact that the highest company earnings in history will be recorded in the quarter ending in March 1990. The sun also has been shining on shipping and the shipbuilding industry which had been stagnate for a long time, and it now appears that they will once again be huge substantial industries.

There is speculation, however, that considerable disability will appear in this prosperous economy in 1990. At the conference of finance ministers from five advanced countries [G-5] at the Plaza Hotel in New York in September 1985, the policy of a high yen and cheap dollar was confirmed. Since then, the Japanese Government has taken steps to stimulate the domestic market by a policy of expanding domestic demand and companies have attempted to take a second look at global strategies.

As a result, Japanese prosperity began to increase in fiscal 1987 and since then, the Japanese economy has continued in a booming period. It can be said that the policy demanding domestic expansion has pushed up Japanese industry in general but amidst this, Japanese society has changed and is facing a new age. New industries to match that age have reared their heads and the industrial structure of Japan also is rapidly changing.

The Showa era (1926-89) basically was an era that promoted industrialization, but it can be divided into two ages with 1970 as the demarcation line. From 1926 to 1969, there was the great change influenced by the Second World War, but it was basically an age in which Japanese society tried to catch up to the advanced nations of Europe and the United States in the economic sphere. That can also be called a continuation of the policy of the Meiji era (1868-1912). The Japanese policy both before and after the war was to introduce technology from Europe and the United States, and to promote industrialization centered on the heavy chemical industry. The people also agreed with that.

In other words, it can be said that Japan up to 1969 was an industrialized society. The reason that industrialization was promoted is that there were insufficient material goods necessary for life and business activity. It was an industrialized society that pursued the optimum system for cheap manufacture of things in large volume and the optimum distribution system to sell things cheaply in large volume because of scarcities.

By 1970, however, the material goods necessary for life and the machinery indispensable for business activity had been secured. Material goods were abundant and it became an excess goods society. In other words, it was the end of the industrialized society.

Advent of New Age

In 1970, the world's fair was held in Osaka and 64 million people visited it. The Japanese people had confidence in Japanese industrial power and that year, 1970, was also a year of demarcation in which a contradiction to industrialized society erupted and the beginnings of a new society came to be seen.

In January, U.S.-Japanese textile negotiations began and the diversification of the textile industry, which had been the motive force of the Japanese economy since the Meiji period, was inevitable in order for it to survive. In March, leadership was taken by the steel industry and Nippon Steel Corp. was born by a merger of Yawata Steel and Fuji Steel as a battleship-class company that could withstand liberalization. In July, the generation of photochemical smog was confirmed and auto exhaust pollution was highlighted as a social problem. In December, 14 pollution-related bills were passed.

At the end of this year, a full-scale consumer movement arose occasioned by the issue of double pricing of color televisions and a question mark was cast on the company-centered social structure.

Japan had leaped to second place in the free world with its GNP in 1969 but it was now backed into a corner. Material goods were plentiful and the age had ended in which what was made could be easily sold. Companies aimed to reduce costs further in order to sell, and began to search for products that could be sold.

As a result, the computer was gradually introduced into companies as valuable new product, and efficiency and information-related equipment industries with computers as the core became the star industries. Via two oil shocks, Japan shifted to a society in which the information-oriented social aspects surpassed the industrial social aspects. The social base also moved from the railroads and harbors of former times to computer network systems, and those related industries were extolled as growth industries.

Since 1985, however, a society with abundant items for sale has become firmly anchored and where once individuals had to search for products to buy they now have the power of choice. Individuals are all different with different needs and the current diversity satisfies these needs. As the result of an increase in people aiming at self-realization, new service industries tied to intellectual pursuits suddenly began to raise their heads. For example, industries not seen in an industrial society were born such as the health maintenance and improvement industry including various cultural centers, and various kinds of sports clubs, the leisure industry, and the gourmet industry, and they began to grow rapidly.

The fact that today we are going through what is called the third religious boom is believed to be deeply tied to the desire of people for self-realization.

The rise of these new industries means that Japanese society has shifted to a new society which values knowledge and the mind, different from the high information-oriented society. The writer defines the new society which began in 1985 and will probably reach its peak in the Heisei era as "a society in which man engages in a creative life that enriches his humanity" and calls it "the society searching for self-esteem" or "the age of knowledge and the mind" because the self is valued in a real sense.

Also, today computer network systems have permeated every nook and cranny of society and without the support of computers, company production and sales and even management decisionmaking systems will not materialize. It can be said that computer network systems form the social basis such a society.

Consequently, in the Heisei era which is a "society searching for self-esteem" where the individuals aim at self-realization, companies naturally cannot grow unless they respond to the needs of such a society. The rise of new service industries related to affluence is due to this new society, and it is presumed that such industries will have remarkable development in 1990 and thereafter. Along with new industries, of course, industries related to computer network systems which are the new social base also promise growth in the future.

Restructuring Promoted

Industries blessed by the opportunity of growth in the Heisei era are those connected with computer network systems which are the new social base and services connected with affluence. Companies which are distant from these industries are making inroads into computer network systems and new service industries by restructuring.

Their models are the huge substantial industries of steel and shipbuilding and heavy machinery which had a major role in Japan's economic development until the latter half of the 1960's. These industries are zealously restructuring in order to survive, but the new enterprises are all computer network systems-related, leisure and other new service industries.

The big objectives in making inroads into the new service industries are the use of idle assets and surplus personnel. There are few cases of making inroads by M&A.

In computer network systems-related new industries, however, cases are increasing where existing companies are obtained in affiliation by M&A's. This is because changes in the computer network systems-related environment are rapid and to do business in these areas, a company cannot start from scratch. In other words, there are many cases where M&A's are promoted as a way of buying time with money.

Nevertheless, M&A's in Japan are different from M&A's in the United States. In Japan, companies become a part of their employees lives, and there are many people who actually feel that the company gives them life. Lifetime employment is crumbling, but still there is an inseparable relationship between companies and employees. Indeed, it can be said that the company is society itself for the employee.

Consequently, only friendly M&A's are successful in Japan. Hostile M&A's in which stock is cornered are detested, and it can be said that Japan is a market where M&A's are difficult.

In the United States and Europe, however, and particularly in the United States, companies are thought to be products. It is a common strategy to sell affiliated companies to procure the capital necessary for new enterprises and there are many such cases of M&A's by Japanese companies in the United States. The purchase of Columbia Pictures by Sony and the purchase of the Rockefeller Group by Mitsubishi Estate were made for the convenience of the other party.

According to a study by Yamaichi Securities, there were 483 M&A's in which Japanese companies took part between January and September 1989, surpassing the 469 for 1987. There were 555 for the 1988 year period, which is the highest number, but it appears that 1989 certainly will surpass this.

Looking at the breakdown for January to September 1989, there were 294 cases of domestic companies purchasing overseas companies and 178 cases of domestic companies purchasing domestic companies. There were a scant 11 cases of overseas companies purchasing domestic companies. In the future, as U.S.-Japanese trade friction deepens, it appears this will be taken up as a concrete indicator showing the difficulty of investing in the Japanese market.

In any case, managers consider M&A as an effective restructuring method and it seems that M&A's will be carried out extensively in the future also.

Coping With Globalization

The restructuring of Japanese companies does not limit its sights only to Japan, but it is being conducted on a worldwide scale. Restructuring is deeply related to the globalization of companies and M&A by Japanese companies overseas, particularly in the United States and Europe, can indeed be called a global strategy in itself.

Since the beginning of 1990, local production in the United States and Europe has been vigorously conducted in electronics, centering on semiconductors. In the future, speaking relative to electronics, the method of production at sites of demand such as in the United States and Europe will become common for those on the leading edge.

There are many cases where local production in the United States is conducted by fully financed subsidiaries of the Japanese company. With an eye toward the unification of the EC in 1992, Japanese semiconductor manufacturers are hastily creating production bases in Europe, but in the case of Europe, it seems that there are an increasing number of cases where inroads are made by joint ventures with local capital.

Auto makers also are proceeding with creating a base in Europe in the face of EC unification, and other industries also are working out a clear course for production in Europe in 1990.

Along with such provisions for a production structure in the United States and Europe, an increase of production in Southeast Asia is being considered for future augmentation. In the most aggressive electric appliance industry, leading edge products are produced in the United States, Europe and Japan. Products with seasoned technology in which product quality can be maintained even in Southeast Asia are produced in Southeast Asia and supplied to the world.

Recently, as in the case of Matsushita Electric, it was decided that washers would be made in Thailand and brought into Japan. Previously, it has been said that since home appliances such as washers and refrigerators are bulky, despite production in Southeast Asia where wages are cheap and reverse import into Japan, freight costs pile up and it is not profitable. The idea of producing such applicances at the optimum location anywhere in the world has spread.

There are few cases of making inroads into Southeast Asia in auto-related industries, but the worker shortage has become acute in the auto parts-related industry, and it appears that production in Southeast Asia, along with the acceptance of foreign workers, will become big issues.

Speaking of global strategies, policies on the numerous East European countries which have changed rapidly will be a big issue in 1990 and thereafter. Auto manufacturers currently are taking the lead. Daihatsu Motor Co. is studying inroads in Poland and Suzuki Motor Co. in Hungary. The Ministry of International Trade and Industry (MITI) also is dispatching an investment study team to Poland and Hungary this spring and it appears that industrial circle activity on the East European market will become vigorous about that time. Under the present circumstances, however, there are many companies who are refraining from action.

Concern About U.S. Prosperity

While embracing the issues of trade friction and EC unification, the Japanese economy has shifted to a high level, supported by vigorous domestic demand. Company achievements for the 1990 quarter ending in March unmistakably are the highest recorded in history but on the other hand, a worrisome reduction already has appeared.

First of all, besides the sluggish demand for cars in the United States, the major market, computers, which were the driving force of prosperity, have fallen into a slump. Japan does not sneeze when the United States catches a cold like before, but those influences already are appearing in Japan.

Auto demand began to grow cold in early fall 1988 and it now appears that sales during the 1989 year period will fall below the 10 million level for the first time in five years. On the other hand, the Japanese manufacturers local production structure in the United States is being strengthened from 800,000 cars for the 1988 year period to 1.3 million cars in 1989. The production capability of Japanese manufacturers is expected to increase in the future also and there are estimates are that it will reach 2.3 million cars in the first half of the 1990's.

As a result, auto exports to the United States from Japan are going down, and it is certain that the harsh treatment of Japanese cars will increase in the United States. Along with the inroads into the United States by Japanese auto manufacturers, inroads into the United States by affiliated parts manufacturers also are increasing. This also has become a cause of friction. If Japanese manufacturers do not procure parts from American parts manufacturers, the inroads by Japanese manufacturers into the United States will only become a cause of pressure for U.S. manufacturers. In local contents promoting local procurement, it is anticipated that Japanese manufacturers will take on graver responsibility to promote procurement of parts from other than Japanese parts manufacturers in the future.

The cooling of demand for autos is also tied to a decline in the demand for steel and is affecting Japanese steel manufacturers aiming at local production in the United States of electro-zinc plated steel plate for autos. Japanese demand for steel is more than originally anticipated due to the construction boom and is in good shape, exceeding 100 million tons per year of crude steel. Consequently, increases in local production in the United States and decreases of exports to the United States with the decline in demand for cars will not greatly

affect the record of steel manufacturers, but there is concern about controlled tradeism raising its head as seen in self-regulation.

Demand for computers also is sluggish in the United States and personnel-cut actions have been vigorous among general computer manufacturers and minicomputer manufacturers. Personal computers had been progressing comparatively favorably, but now this seems to be dimming and the effects of that decline in demand is appearing in Japanese semiconductor manufacturers who control over 90 percent of the world's semiconductor memory market.

Production of the most advanced 1M DRAM (dynamic random access memory) already is being tightened by Japan's semiconductor manufacturers to prevent a decline in prices due to a collapse in the balance of supply and demand.

Cloudy Skies Spread Over Japanese Economy

In the case of semiconductors, there is an agreement between the United States and Japan that 20 percent of the Japanese market will be of foreign manufacture, but this is a difficult agreement to uphold. Various electric appliance manufacturers have decided to increase on a large scale the amount purchased from the United States, but the computer slump in the United States is dragging on and when the business of American semiconductor manufacturers goes down because of this, it appears that it will draw even more severe criticism of Japan.

While semiconductor manufacturers in Japan are decreasing production, on the one hand, they are hastening to establish a production structure for the next generation 4M DRAM, and a violent struggle for leadership is taking place. Most of the profit for the major electric appliance manufacturers is created by the semiconductor memory. There is a possibility that the dimming of the demand for semiconductor memory in the United States will directly affect the major electric appliance manufacturers in Japan. The warning light that is on for the electronics-related industries which have had continued rapid growth seems to be casting a shadow on Japan's good prosperity.

Aside from the electronics-related industries, there is concern about the reduction in the number of housing starts which greatly affects business. According to a survey by the Ministry of Construction, the number of new housing starts in the first half of fiscal 1989 was 869,389, a 1.1 percent decrease compared to the same period the previous year. This is the first time in six years that it has been less than the same period the previous year. In so far as housing construction has a great ripple effect, there is concern about the influence on business. In the future also, a supply of cheap housing will become impossible with the sudden rise in land prices, and housing construction will no longer shoulder the role of the driving force of prosperity.

While this gloom in the prosperity which has continued since 1987 can be seen, on the one hand, there are also industries which are smiling at a business recovery. Machine tools, production machinery, shipbuilding, and others are growing. In the case of shipbuilding, although it is growing, it is far from the past level, and apparently will not play a part as a driving force of the economy in the future either.

The growth of machine tools and various kinds of production machinery is related to the changes and diversification in the needs of society and companies. Since these strongly changing needs cannot be met with existing production facilities, manufacturers have begun to aim at a new CIM (computer integrated manufacturing) structure directly connecting sales information and production information, tied to demand. Since it is anticipated that renovation of production facilities to meet this new age will continue in the future, it seems the record of machinery manufacturers will continue to be promising in the future.

Overall, however, prosperity has begun to slow down, depending upon the kind of industry and it is anticipated that there will be some gloom seen in the prosperity, spreading clouds over the Japanese economy in 1990.

* Extension of Cheap Yen Changes Scenario

90JA0086 Tokyo NIHON KEIZAI SHIMBUN in Japanese 17-21 Jan 90—FOR OFFICIAL USE ONLY

[17 Jan 90 p 5]

[Interview with Masaaki Nakao, Bank of Tokyo Research and Statistics Bureau director; interviewer not identified; date and place not given; first paragraph is NIHON KEIZAI SHIMBUN introduction]

[Text] *The market in the new year shows signs of a developing storm as it starts with lower values for the yen, stocks and bonds. The possibility of realizing the scenario—"lower U.S. interest rates will lead to a shrinking of the gap between domestic and foreign interest rates, and this will lead to a reversal back to a high yen"—has receded. We asked the experts for their views on how domestic prices, business activity and market trends will change as the yen continues to remain low.*

Narrow Path for Monetary Policy: Watch the Transition from Money to Goods, Investment

[NIHON KEIZAI SHIMBUN] The value of the yen has been in the 140's for half a year. What has been the effect on prices?

[Nakao] Companies gradually have begun to expect the yen to be lower in the next 6 months. At the company hearing in November 1989, the yen rate was Y5 lower than in August. Some companies have started to revise their intra-company rate downward, and I am worried that they will abandon the posture of not letting prices carry the burden of increases in the cost of imports. No domino effect leading to price increases has appeared

yet, but if it does, it will be disastrous. I think that it is important to nip it in the bud.

The safety-valve effect of imports on prices also has lessened. In addition to increased cost of imports because of the lower yen, the increase in debt of newly industrialized economies is raising the cost of imports.

Influence of Domestic and External Political Situations

[NIHON KEIZAI SHIMBUN] Is the reduction of the interest rate gap having less effect on the yen rate now?

[Nakao] According to economic principles, the yen should rise if the difference in domestic and foreign real interest rates is reduced. That is why the official discount rate was raised three times. It is also true, however, that the market will not be moved by minute adjustments to reduce the gap in interest rates. It is the fate of a creditor country that there will be an outflow of funds exceeding its current account surplus and that this will apply constant downward pressure on its currency; and in Japan's case, the outflow is going mainly to the United States. In addition, there is speculative investment because of the East-West detente and other domestic and foreign political circumstances. If we want to maintain the expansion of business activity even in such an environment, we cannot fully apply the brakes in the financial sector, so we are walking on an extremely narrow path.

[NIHON KEIZAI SHIMBUN] How do you view the substantial drop in the stock and bond markets?

[Nakao] Stocks continued to rise, reflecting the expansion of company assets due to rising land prices, but land prices inherently contain a bubble. The continuing decline is an indication of the fragility of that kind of stock price formation, and is a natural course of events.

The decline of the bond market and long-term increases in interest rates need to be watched to see whether they will make investments shift from money to goods.

Danger of Too Rapid Growth

[NIHON KEIZAI SHIMBUN] Various problems have emerged as the domestic economy matures, such as the fact that shortage of labor has become serious. If it seems that the growth rate will become even stronger, will it be necessary to raise interest rates to curb demand?

[Nakao] It is difficult to say how much we need to drop the growth rate to have a favorable effect on prices, but certainly, too much acceleration is dangerous. However, I do not think that we have reached the point where prices will become inflamed unless the growth rate is suppressed deliberately.

Nevertheless, we must keep a sharp eye on wage trends. The majority view is that the rate of increase in wages will be bigger than last year. I see private sector demand slowing in the latter half of FY90, but if the demand for labor continues to grow stronger, regular wages, extra bonuses as well as part-time wages and overtime pay will rise. On the other hand, since productivity will not increase as much as it has in the past, wage increases will become a cost increase factor.

[NIHON KEIZAI SHIMBUN] How do you view the effect of higher crude oil prices and price trends until spring? If financial policy changes become necessary, what should their key points be?

A Watch on Continuing High Price of Crude Oil

[Nakao] Crude oil prices will rise in the spring, and the January-March rate of increase in wholesale prices may be somewhat higher than it was for October-December 1989. First of all, it is important to ensure that imported inflation does not become domestic inflation, so we will very carefully watch to see whether the yen continues to go down in value and whether crude oil prices remain at high levels even when seasonal factors are eliminated.

[18 Jan 90 p 5]

[Interview with Tsutomu Tanaka, Economic Planning Agency Research Bureau Director General; interviewer not identified; date and place not given]

[Text] **Labor Demand Is Key to Prices; Drop in Stocks and Bonds Will Sustain the Economy**

Political Factors Influence the Yen

[NIHON KEIZAI SHIMBUN] Despite three increases in the official discount rate last year, the yen to dollar rate has remained in the 140's. The value of the yen remains low.

[Tanaka] Although the difference between U.S. and Japanese interest rates has been reduced by raising the official discount rate and other measures, domestic and external political factors have influenced the low yen-high dollar situation. Since last summer, the cloudy future of Japanese politics has been a factor in keeping down the yen, while the situation in the Soviet Union and Eastern Europe has raised the value of the dollar and the Deutsche mark. On top of that, it is also possible to interpret the low yen, which has continued since last year, as a correction of a yen that had risen too much after conclusion of the Plaza Accord. Purchasing power parity of U.S. and Japanese industrial products is balanced when the yen to dollar value is in the 140's.

[NIHON KEIZAI SHIMBUN] Won't the low yen affect prices?

[Tanaka] The low yen has continued for over a year, but because the international commodity market has been stable, wholesale and consumer prices are stable. So far, there is no sign of a feeling that prices will rise in the future. Certainly, we must be mindful of future import price trends, but as far as prices are concerned, I am more worried that the current labor shortage will lead to wage increases and that will affect cost and therefore cause price increases.

On the other hand, there is fear that if the low yen continues, it will delay improvement of the trade balance. Exporting firms have shifted to a domestic demand orientation at some cost while contending with the high value of the yen since the Plaza Accord. If such firms are placed in a position where exporting is more profitable, the current account surplus may expand once more.

[NIHON KEIZAI SHIMBUN] Business activity is good in Japan, as usual. What about the future?

[Tanaka] The government's outlook is that real economic growth will be 4.6 percent in FY89 and 4.0 percent in FY90. The economy is growing at cruising speed. Last year, there was hasty purchasing and reactionary activity in anticipation of the introduction of the consumption tax, and the quarterly growth rate fluctuated, but it is stable now. The number of months that private companies had machinery orders in hand, as of November 1989, was 10.7 months, so a high level has been maintained. Potential demand, including for individual consumption, is strong. On the other hand, because there are limits to productivity, this demand has been put off. If the condition of stable prices is met, the sustainability of business activity will be quite strong.

No Sudden Crash

[NIHON KEIZAI SHIMBUN] How do you view the drop in the stock and bond markets?

[Tanaka] The stock market went too far all over the world. During the latter half of 1989, the movements in the Soviet Union and Eastern Europe were seen as favorable elements, but the current instability in the Soviet Union and other changes have removed any excessive hopes. It is a kind of adjustment process. In the United States, reaction to the merger and acquisition boom, falling corporate profits and other unstable elements still remain. Although small adjustments may continue to occur, it probably will not evolve into a sudden crash.

In Japan as well, the current drop in the stock and bond markets was not caused by a worsening of the fundamentals of the economy, and they are not affecting those fundamentals. Rather, they will probably suppress overheating of the economy and help to sustain good business conditions. However, we must watch to see whether funds will flow from stocks to land and cause a rapid acceleration of land prices, or whether the rise of long-term interest rates will have a negative effect on housing construction.

Correction of "Excess Money" Is Necessary

[NIHON KEIZAI SHIMBUN] What are the points to watch for now in economic policy management?

[Tanaka] First, wage and price trends. Policies must be used to nudge things along so that the demand for labor will ease. For example, the percentage of women of employable age who are working has risen almost to 50 percent. To raise this even higher, it would help to raise the minimum wage that can be covered by deductions for dependents.

The excess money economy should be corrected gradually. Absorption of excess fluidity by measures such as raising the official discount rate is important, but at the same time, absorption through expansion of social capital also is necessary.

[19 Jan 90 p 5]

[Interview with Yoshio Suzuki, Nomura Research Institute deputy director; interviewer not identified; date and place not given]

[Text] **Revision Toward Lower Dollar; Worsening of Fundamentals of U.S. Economy**

Expansion of the Gap in Inflation

[NIHON KEIZAI SHIMBUN] How do you see the future of monetary relaxation in the United States, which influences the value of the yen?

[Suzuki] Although U.S. business activity clearly is slowing down, prices and the rate of increase in wages have hardly dropped at all. There are two ways to interpret this. One is that it is simply a time lag problem. If so, it is possible that in the first half of 1990, interest rates will go down and the official discount rate will be lowered. The other interpretation is that the U.S. economy has hit bottom and will head back up (the "touch and go" viewpoint). If so, rising prices will preclude lowering the official discount rate.

If U.S. interest rates fall, the dollar will head down. Even if interest rates go up, the cause will be a rise in prices. In either case, because the fundamentals of the U.S. economy have worsened, the trend will be toward a lower dollar and a higher yen.

[NIHON KEIZAI SHIMBUN] Isn't it true that due to the influence of political circumstances such as the situation in the Soviet Union, exchange rates no longer reflect the reduction in the interest rate gap between Japan and the United States?

[Suzuki] It is certainly true that the Soviet and East European problem as well as the political situation in Japan are disruptive factors, but we do not know whether they will continue to act as downward pressure on the yen. Even if the Liberal Democratic Party does not hold onto its majority in the lower house, if it is able to achieve harmony on policy with the other parties, it may lessen the feeling of uncertainty about the future of Japanese politics among those involved in overseas markets. The sense of uncertainty about the future is what is influencing the exchange rates.

[NIHON KEIZAI SHIMBUN] Will it become a movement that will affect economic fundamentals?

[Suzuki] We must not forget the real difference in interest rates that comes from the difference in inflation. In Japan, the rate of increase in prices will be lower than last year because the consumption tax portion will be peeled off from April. Eventually, those involved in the market will become aware that, when a comparison is made with the rate of increase in prices in the United States, the difference in inflation rate between the United States and Japan is growing, and that probably will be effective (in raising the value of the yen).

[NIHON KEIZAI SHIMBUN] Don't some people think that interest rate increases and fear of inflation in the future are factors in long-term interest rate increases?

[Suzuki] Because it is felt that the yen will continue to remain low, more and more people think that the rise in short-term interest rates is not temporary, and it is a movement to narrow the spread. At this stage, it is reflecting the continuation of the low yen rather than concerns about rekindling of inflation.

"Gradual Rise to a High Yen" Is Best

[NIHON KEIZAI SHIMBUN] I think that in order to forecast future price trends, many people are watching to see how much wages will rise as a result of the spring labor offensive.

[Suzuki] If the rate of increase of wages is high, it will start to affect prices around the beginning of summer. Some people think that the Bank of Japan will take preventive measures to forestall price increases, and that is why long-term interest rates have gone up.

[NIHON KEIZAI SHIMBUN] If prices are stable now and there are factors that will make them less than the preceding year by April, there is little justification for raising the official discount rate.

[Suzuki] It is old-fashioned to think that interest rates cannot be raised as long as prices are not increasing. I think the people will go along with it just for the reason that the low yen is continuing.

[NIHON KEIZAI SHIMBUN] There is also the view that even if the yen is low, it is not a problem as long as it is stable.

[Suzuki] If the yen stabilizes at a low level, overseas inflation will be imported directly, and it also will lead to re-expansion of imbalance with other countries. The best scenario is for the yen to move upward gradually.

Economy Can Absorb Further Interest Rate Increases

[NIHON KEIZAI SHIMBUN] To raise interest rates when prices are going down is not prevention, it is a full-scale tight money policy.

[Suzuki] Japan's actual interest rate was extremely low. That was a temporary measure to avoid a high yen slump. The real growth rate for July-September 1989 was 12.3 percent. For an economy that was moving at full speed, the official discount rate was too low.

[NIHON KEIZAI SHIMBUN] Will the Japanese economy still be in good shape if interest rates are raised yet again?

[Suzuki] Judging from present circumstances, further increases in interest rates can be absorbed. In 1990, there will be a leveling off, where the ratio of current profit to net sales will not go down even if the pace of increase in income and profit slows down. Business activity will continue to be good and there will be no effect on investment in plants and equipment by the companies.

[20 Jan 90 p 4]

[Interview with Takuro Ban, Industrial Bank of Japan research department director; interviewer not identified; date and place not given]

[Text] **Prices Will be Stable For Now; Probably No Unilateral Lowering of Yen**

Relaxation of U.S. Monetary Conditions Should Be Gradual

[NIHON KEIZAI SHIMBUN] Some say that we can no longer expect that with the slowdown of the U.S. economy, an easy money policy will be adopted and the interest rate gap between Japan and the United States will shrink.

[Ban] As for the state of the U.S. economy itself, the opinion that the manufacturing sector will slow down has not changed much. Since layoffs, especially in the automobile industry, will increase after January, the long-standing scenario of a slowdown in the U.S. economy has not changed.

The problem is prices. Because of the cold snap, crude oil prices are somewhat high, but I do not think that they will increase as they did in 1985. The underlying trend can be kept stable. Price increases can be viewed as temporary. Therefore, I think that a relaxation of monetary conditions in the United States will progress somewhat, even if it is slower than we originally expected.

[NIHON KEIZAI SHIMBUN] There is doubt that the yen will go up even if the relaxation of monetary conditions is established clearly in the United States.

[Ban] It is true that domestic and external political factors, that is, Japan's election and the instability in Eastern Europe and the Soviet Union, are factors that keep the yen low and tend to lead to market psychology that keeps the dollar strong in times of emergency. Therefore, it is better to view this as a tug-of-war between these political factors and economic factors such as the reduction of the interest rate gap, and this makes it difficult for the reduction of the interest rate gap to influence exchange rates directly.

[NIHON KEIZAI SHIMBUN] Assuming an exchange rate of around Y145 to the dollar, I see the FY89 wholesale price index increasing at a rate of around 3.5 percent because of the stability of the international commodity market and a boosting effect from exchange rate factors. However, the last period will be more stable than the first period when month to month comparisons are made.

The stability of goods-based prices so far has been due to the fact that basically favorable business activity and quantitative expansion has made it possible to absorb cost-raising factors. On the whole, since FY89 corporate profits will continue to be high, there is not much danger that inflation will be rekindled because higher costs are shifted onto prices.

Economy Will Slow Down in the Last Period

From April, the price-raising factor of the consumption tax will be gone and crude oil price increases also are not very likely. I think prices will settle down to a great degree. There also is not much danger that the vicious cycle of wage increases and price increases will be set into motion by the spring labor offensive.

The problem is exchange rates. Certainly, domestic and external political factors are unstable and can easily lower the yen, but I do not think that we need to worry that they will unilaterally push down the yen in a major way.

[NIHON KEIZAI SHIMBUN] What is your prediction for the economy?

[Ban] If the rate of increase of wages goes up and the tempo of production increases slows down in FY90, it is quite conceivable that the corporate profit environment will change and companies will change their view of business conditions. I also think that investment in plants and equipment will slow down somewhat during the last period. The economy itself probably will slow down, and it will show up in the last period. Nevertheless, I think that a growth rate of close to 4.5 percent probably can be maintained.

Exchange Rate Depends on Political Factors

[NIHON KEIZAI SHIMBUN] Will the official discount rate be raised another step if the yen cannot be kept from falling and money supply does not go down?

If we take into account a real narrowing of the gap between domestic and foreign interest rates, the tug-of-war between economic and political factors, and the Group of Seven (G-7) cooperation, the value of the yen which is boxed in at Y140-145 to the dollar is neither too low nor too high. The problem is to what extent downward pressure on the yen should be prevented by reducing interest rates, but that is difficult to predict because it involves the degree of progress made on easing monetary conditions in the United States. Assuming that my prediction that the United States will ease monetary conditions to some extent is true, the current level of Japan's short-term interest rates does not have to be raised that much.

However, there also is the question of how much exchange rates will be effected by political factors, and it is difficult to reject the possibility that interest rates will be raised another step. Viewed optimistically, Japanese political factors cannot get any worse than they are now. In any event, it is a matter of whether anything will be left if political factors counteract the fundamentals of the economy. I hope that it all balances out.

[21 Jan 90 p 3]

[Interview with Sumio Karachi, Sumitomo Trust director of Pension Fund Investment Department and Public Funds Investment Department; interviewer not identified; date and place not given]

[Text] **Receding Possibility of Yen Reversal and Rise; More Maneuvering in Risk Dispersion, Application of Funds**

[NIHON KEIZAI SHIMBUN] From the position of an institutional investor, how do you view the movements of the yen, stock and bond markets since the beginning of the year?

[Karachi] There is quite a difference between the scenarios drawn by the markets at the beginning of December 1989 and the beginning of this year. That difference has brought on the so-called triple lowering of the yen.

Market interest is focused on two things: U.S. financial trends and the global political situation. In December, the soft landing of the U.S. economy was successful, and it was expected that there would be progress in the relaxation of U.S. monetary conditions by the U.S. Federal Reserve Board (FRB). It also was assumed that progress toward democratization in Eastern Europe would work positively on the capital market.

However, the market appears to have jumped the gun. In fact, crude oil price hikes have brought on another round of rumors of U.S. inflation. Uncertainty about Soviet Chairman Gorbachev's power base has grown stronger. Therefore, even small rumors and demagoguery can cause chaos in the market.

Tokyo Market Started Tremors

[NIHON KEIZAI SHIMBUN] Will these market conditions continue for a long period?

[Karachi] Current conditions are strictly a correction of the December market, which had become too strong. They merely reflect the fact that excessive expectations have been stripped away. There has been no basic change in the market. The sudden increase in U.S. wholesale prices in November involved some distinctive factors such as crude oil, foodstuff and tobacco. It is hard to believe that crude oil, which is entering a period of low

demand, will continue to increase in price. Unmistakably, the U.S. economy basically is slowing down.

Political factors also are difficult to read, but I do not believe that Chairman Gorbachev's status has changed decisively. However, there is an element of uncertainty being amplified by small occurrences.

My one point of concern is that the Tokyo market was the source of the recent tremors. Thus far, Tokyo has acted as a breakwater against market fluctuations. If things crumble in Tokyo, it might set off a chain reaction of negative effect all over the world.

Era of Diversified Investment

[NIHON KEIZAI SHIMBUN] Although it does not appear that the yen will fall suddenly vis-a-vis the dollar, it has continued to slide vis-a-vis European currencies.

[Karachi] Certainly, if we make a comparison with economic factors alone, for example the economic growth rate for the next fiscal year, Japan might be number one. However, if we look at political balance, Japan obviously suffers by comparison. It is doubtful that Japan's political situation will be stable after the February election. As long as the system of cooperation among the advanced countries is firm, the value of the yen is not likely to break away from the level of Y150 to the dollar, and the possibility that it will do an about-face and rise has died out completely.

[NIHON KEIZAI SHIMBUN] As an institutional investor, with what posture will you apply your assets?

[Karachi] Basically, we expect the yen to remain stable at its current level, so for the present, we do not intend to change our exchange rate hedging ratio.

We have entered an era of full-scale international diversification of investments. Annuity trusts started making investments abroad from around 1981. In the first period, investments were diversified based on traditional portfolio theories, but as the value of the dollar went up, the inclination toward dollar assets rapidly grew stronger. They were able to survive the sudden drop in the dollar after the Plaza Accord through exchange rate hedging, if the truth be told, and have not yet built new, optimum portfolios.

European stocks are small receptacles for funds and it would be difficult for them to become the main thrust of fund application, but the importance of investment in Europe will increase. At first, European Community (EC) market integration in 1992 was seen to be the turning point, but I think that the breaking down of the Berlin wall has accelerated that date. Where there is great change, there is commensurate opportunities for profit.

Involvement of Political Factors Make Market Uncertain

[NIHON KEIZAI SHIMBUN] It is thought that investment uncertainties have suddenly increased for investors.

[Karachi] Exactly. The fact that the market reacts to concerns about political conditions has greatly increased uncertainties. Dispersion of risk will become much more important and greater maneuverability in investment will be sought. Investment skill will show up very clearly.

[NIHON KEIZAI SHIMBUN] The phenomenon of the reversal of short-term and long-term interest rates is tending to disappear all over the world.

[Karachi] It would be more natural for the disappearance of the reversal to be caused by the falling of short-term interest rates, not the rising of long-term interest rates. In that sense, the disappearance is not necessarily desirable for Japan. It would be one thing if short-term sales profit was the goal, but since we invest in bonds from a long-term viewpoint, the disappearance will make full-scale entries into the bond market difficult. On the other hand, a 6.7 percent yield on long-term bonds might be high enough to allow us to embark on purchasing.

* BOJ Fears World Where $1 Equals Y200

902A0121A Tokyo SHUKAN DAIYAMONDO in Japanese 10 Feb 90 pp 8-13—FOR OFFICIAL USE ONLY

[Article based on the analysis of Mitsuo Suzuki, representative of "Acton"]

[Text] *The days when the economy could be explained by economic factors alone are over. If we inspect the situation from the viewpoint of a strategy which includes politics, we can see a world project begun by the Soviet Union and sketched by the United States. Japan is built in to this strategic circuit whether willing or not, and the situation feared by the Bank of Japan [BOJ] where $1 is worth 200 yen is looming as a possibility. The four scenarios here tell how what were once the five advantages of land, stocks, interest rates, oil, and yen are transformed into a "quintuple disadvantage"; and follow the structural reform of Japan itself.*

Prologue: The First Step Toward the Rebirth of a Strong America

President Bush is serious. In the administration's first budget message for fiscal year 1991, presented to Congress on 29 January, the first small but certain steps were taken toward the rebirth of a "Strong America."

The government economic forecast, from a staff which from Office of Management and Budget Director Darman on down is composed of pragmatists, estimates that inflation in consumer prices will be reduced from the 4.8 percent in 1989 to 3.0 percent in 1995, and that interest rates on 10-year government bonds will fall

significantly from 1989's level of 8.5 percent to 5.4 percent in 1995. In other words, this is an indication that the United States intends to accomplish politically a switch to a domestic-demand orientation.

The plan also called for reducing defense expenditures by 2 percent per year, and the joint agreement by the governments of the U.S. and the Republic of Korea to close three American bases in Korea, announced the same day, showed America's strong intention to cut defense spending. The desire to change the existing structure of the United States is substantiated on the budgetary side by plans to halve the deficit without raising taxes by controlling government spending, to make savings tax-exempt, and to increase the education budget.

Many Japanese economists say that the forecast is too rosy because of excessive expectations of economic growth. Nevertheless, taking those first steps is very important. And what about Japan?

Compare the demands made by the two sides in the Japan-U.S. Structural Impediments Initiative [SII] talks . It is clear that Japan is solving none of the problems identified by the United States; not taking a single concrete step. In future negotiations between Japan and America, the United States will certainly strike at this point.

Scenario 1: Funds Will Be Required for the Economic Reconstruction of the Soviet Union and Eastern Europe

Last year, at the Malta summit between Bush and Gorbachev, the participation of the Soviet Union as an observer in GATT (the General Agreement on Tariffs and Trade) was proposed. In fact, this was related to the participation of the Soviet Union in the IMF (International Monetary Fund,) proposed at the U.S.-Soviet summit in June.

The IMF provides its member countries with various sorts of loans, granting of credit, interest credits, and so forth. For ordinary withdrawals a concrete policy proposal is required, but as long as that requirement is met it is easy to borrow funds; and if the Soviet Union were to join, it would make it easier to guarantee the large demand for funds needed by the USSR through trade with Western firms.

At the beginning of this year the British Treasury announced that it is preparing to decrease its IMF investment quota from the current 6.88 percent to just over 6.0 percent at the time of the ninth capital increase, and to surrender the number two position to Japan (now number five with a 4.69 percent quota.)

Meanwhile, the accumulated debt of the Soviet Union at the end of June, 1989, stood at $45.2 billion. In only half a year, it had increased by approximately $6 billion. The volume of oil produced in the Soviet Union is about 600 million tons a year. Nearly 200 million tons are exported, but half of this is supplied to the countries of CMEA (the Council for Mutual Economic Assistance) at a great discount as economic aid, and only 100 million tons remain for export to the West as a source of foreign exchange.

For an extreme realist like President Gorbachev, there is no telling "how much better off the USSR would be, if it had security fears, if as a practical necessity it cut itself off from Eastern Europe." (Kazuo Ogawa, vice chairman, Soviet and East-European Trade Association.) The Soviet Union, which must have oil for the activation of its domestic economy, truly wants to greatly cut the volume supplied to Eastern Europe, and send some of that oil to the West in order to acquire hard currency. In that sense, it can be said that the revolution in Eastern Europe was born of practical necessity in the Soviet Union.

In this connection, looking at what has happened since Gorbachev came to power, the price of a barrel of oil fell from a peak of $30 in 1985 to $10 in 1986, and has not exceeded $20 since. If we convert Soviet crude oil exports of 200 million tons to barrels, and add those up while taking into account the price differences between periods of high prices and periods of low prices, we get a figure which almost matches the accumulated deficit of the Soviet Union as of the end of 1988, $39 billion. In other words, the Soviet Union lost its huge accumulated deficit due to the drop in oil prices, equivalent to profits it could have earned.

Scenario 2: The Price of Oil Increases Sharply

Increased aid will be required, through organizations such as the IMF, for the economic reconstruction of the Soviet Union and Eastern Europe; meanwhile, how widely should funds be distributed by the world's largest creditor nation, "moneybags" Japan? That is the situation in the world in 1990.

Although production volume in the OPEC (Organization of Petroleum Exporting Countries) nations is tending to increase, oil prices are rising, and the OPEC crude oil basket price has finally passed $20. In addition to the increase in demand by oil-consuming countries, there is the prospect of a doubling of the amount consumed in Eastern Europe and in Asia. The Mitsui Bank General Research Institute is predicting that a third oil crisis will occur from the end of 1992 to the beginning of 1993.

The oil price increase will have a positive effect on the economic reconstruction of the United States and the USSR. The CEMA countries make decisions according to the transfer of rubles, but as long as the value of the ruble was fixed and did not rise, it was of course difficult for the West to establish ties to Eastern European countries. (The official provisional rate is 0.61 rubles to the dollar, but at a recent foreign currency auction $1 was worth 9.56 rubles.) Following the proposal for the establishment of a new ruble announced by the Soviet Union in April 1989, Secretary of State Baker indicated in October that the currency would be supported.

Furthermore, a proposal has been tabled for the establishment of a "gold plus oil standard" based on a basket formula of gold and oil prices. With such a system convertibility to hard currencies would be achieved, and the function of increasing oil prices in supplementing the value of the ruble would be preserved.

In this connection, the number of oil drilling rigs in operation in the United States, which had fallen to 700, exceeded 1,000 in November 1989 for the first time in 21 months; and reached 1,079 in December. With the increase in prices, it has become possible to cover costs. The price of oil in the United States is about one-fourth the price in Japan.

Because the United States has turned into a net importer of oil, analysts in Japan point out that an increase in crude oil prices has a negative effect on the U.S. economy. However, the country which suffers the most is not the United States, where prices were low from the beginning, but Japan. When crude oil goes up, not only does American production become profitable (it does so at $18 per barrel,) but part of the price increase can be recovered through the resulting increase in the value of the dollar.

Due to environmental problems the use of coal and nuclear power cannot be increased. If full production continues, proven oil reserves outside of OPEC will last at most 20 years. Like it or not, the level of reliance on OPEC is increasing.

In the face of the effects of crude oil prices on the economies of Eastern Europe, the aid and extension of credit of the IMF are the only hope those economies have. The United States, is backing Poland 100 percent, the Eastern-European country with the largest accumulated debt, because of a history of ties that dates back to the volunteer army Poland supplied during America's War of Independence, and the presence in the United States of more than 10 million people of Polish descent. One can also assume that the United States will appeal for aid for Eastern Europe from the Middle East.

Incidentally, in these circumstances Japan, which is hurriedly seeking the friendship of the countries in the Middle East, has not set any records in recent years for the number of visits at the prime ministerial or cabinet levels to Middle Eastern countries. At some point the difference from America and Europe, which have built up friendship over the years and whose ministers make one visit a month to the region, will become clear.

At the end of January OPEC, responding to increased demand, asked Japan for financial cooperation in a $60 billion investment to increase supply capacity by 1995. This is a bold strategy in anticipation of a rise in oil prices, and it is proof that once again OPEC has begun to take the initiative.

If oil prices increase, money flows into the oil-producing countries of the Middle East, and these funds are then used for the purchase of instruments such as U.S. Treasury securities. Even if Japan does not buy these securities, the United States can raise the capital it needs from the Middle East. The United States will either request that the Middle East aid Eastern Europe by supplying crude oil at low prices, or, if that is not possible, will be able to arrange the flow of capital through the IMF. Like blood, oil will flow if there is a circuit for it to follow; and it is tied up with economic activation.

Without a doubt, the world strategy is beginning to operate according to the scenario begun by the Soviet Union and polished off by the United States. Even if by some chance Gorbachev should fall, this strategic circuit once started can no longer be stopped. Thus Japan is compelled to recirculate its money through the two prongs of higher oil prices and the IMF. This year one barrel of oil will reach $25. Next year or thereafter, it will probably rise to $30. Has moneybags Japan not once again been caught unprepared?

Scenario 3: The Stage Has Been Set for America's Resurgence

The President's State of the Union message this year attracted attention because it revealed a desire to reform America's problem areas and concrete measures to tackle them. For example, the United States is showing movement toward (1) easing the control of the antitrust laws, facilitating industrial cooperation; (2) putting money into high-technology research and development, currying favor with Japan to make Japan transfer technology through joint development; and (3) extending favorable tax treatment to encourage savings; in contrast to Japan where structural reform is making very slow progress.

Moreover, the U.S. money supply, which increased 11.8 percent in the first quarter of 1988 compared with the same period the previous year, grew only 9.6 percent in the third quarter of 1989. There are those of the opinion that if the dollar strengthens, exports will fall, and it will have a negative effect on American economic reconstruction. However, this too is a Japanese argument put forward by Japanese economists.

Eastern Europe is expected to become a market for American products, and there is movement toward easing COCOM [Coordinating Committee on Export Controls] regulation. The United States and Canada have joined the Conference on Security and Cooperation in Europe from across the Atlantic Ocean, and are part of the so-called "united Europe." As the extent of domestic demand is different, it is now America's job to promote domestic demand.

As for the question of technology, while resorting to a strategy of patent fights and structural talks, the United States will cleverly take Japan's technology. For example, at the negotiations concerning joint development of the FSX next-generation support fighter, it was decided that Japan would furnish the technology for manufacturing the main wings, and this technology

could be widely used for civilian purposes. Moreover, the compensation paid to the Japanese manufacturer for the technology furnished is to be paid to the United States by Japan's Defense Agency.

There are three steps the United States is planning to gain predominance in technology. The first step is to give a strategic shake-up to Japan's comparatively superior technology, and to take that technology by means of technical tie-ups. The second step is to revise the anti-trust laws to encourage cooperation between American firms. The third step is to channel money into technology development by reducing spending on defense.

Many believe that with the layoffs in the auto industry, the stagnation in computers, and so on, the reconstruction of America's economy is in trouble. However, as a result of IBM's personnel reductions and other reorganizations for 1990, profits are expected to increase 50 percent. The results of layoffs are easily seen, and there is enough mobility that laid-off workers can move to states where conditions are better. The unemployment rate of 5.3 percent can be called full employment. If the dollar strengthens, prices will stabilize, an issue in the mid-term elections. The United States is also putting emphasis on research and development and on education. Savings have increased, and capital has been flowing in from all over the world. This is appreciated by the American people, and President Bush's approval rating is the highest of the postwar period, surpassing those of Reagan and Kennedy.

If the yen falls Japanese exports will increase, but in the current international climate, Japanese exports are not accepted the way they once were. The United States can obtain Japan's best items through technical cooperation, and use Japan's money to pay for the rest. Finally, the United States is demanding that Japan share defense expenditures. (Already 45.9 billion yen has been appropriated in Japan's budget to cover the wages of Japanese employees of the American forces stationed in Japan.)

In Asia, as in Europe, the Cold War threat is disappearing; the Soviet Union is withdrawing from Vietnam's Cam Ranh Bay, and three American military bases in the Republic of Korea are being closed. By contrast, in the state of "cold peace" between Japan and the United States, the idea of a Japanese threat has loomed increasingly large. In a report concerning long-term security strategy, the American Commission on Integrated [Long-Term] Strategy in 1988 identified Japan as a "potential threat" to the United States, and said that "the collapse of the Japan-U.S. Security Treaty is not unthinkable."

When the United States proposed abandoning the security treaty, the yen plummeted. At the same time, in January of this year, former President Nixon submitted a secret memo following his trip to China, which said that the restoration of Sino-American relations was necessary for the containment of Japan and the Soviet Union; suggesting how strong the feelings of wariness toward Japan are growing in the United States

From now on Japan will pass through many stages, and will be assailed by America, Europe, the Middle East, and countries all over the world demanding assistance. Moreover, the United States is even trying to make friends with Japan's consumers on such issues as land and the distribution system.

Scenario 4: Concern About Domestic Demand has Appeared

In the spring labor offensive, the burden of cost increases due to the labor shortage will reach six to seven percent. The increase in wholesale prices in 1989, 2.5 percent, was the highest in nine years, but in fact of the 1,253 items measured, the only services are electricity, gas, and water. Items such as office rents, transportation costs, and leases whose costs are increasing are not measured. Furthermore, interest rates on housing are up, and this is having an influence on housing construction. It is becoming difficult for both corporations and individuals who borrow money against real estate, due to the twin effects of the weak yen and the increase in oil prices.

Whether the Liberal Democratic Party [LDP] wins or loses the general election, problems will arise. Even if the LDP takes a majority of 257 seats, it will need to obtain support from outside the cabinet in order to conduct political business, and the views of the opposition parties will inevitably be considered. To hold the chairmanships of all 18 standing committees in the House of Representatives, the LDP will need a landslide victory of 271 seats. Even then the cooperation of the opposition in the House of Councillors will be indispensable. Win or lose, the LDP faces a difficult situation.

Land, stocks, interest rates, oil, yen. What were formerly five advantages have now become a "quintuple disadvantage." Japan, which has raced ahead with economic growth while neglecting to provide sufficient social capital, has come to a major crossroads.

The cause of the instability in stocks is connected with the overseas selling of yen and buying of dollars, and the rise of the dollar is accelerated by the purchase of foreign stocks and foreign bonds.

Yet Official Development Assistance (ODA) and contributions to the IMF cannot be reduced. Japan has gradually become caught up in the strategy of the United States and the USSR. It is likely that the yen will fall to 180 yen to the dollar within the year, and to 200 to the dollar next year or thereafter. The time has arrived when calculations of purchasing power parity (for consumers) indicate that the exchange rate should be corrected to 200 yen to the dollar.

The days of holding assets in yen alone are over even for individuals. The American assertion that voting rights should not be recognized in mutual ownership of stocks will also have a negative effect on stock prices.

With this development, the number of Japanese firms which become targets of mergers and acquisitions will probably increase. The true leadership of professionals will come to be desired for the management of corporations. The ability to conceive strategy and to see things in broad perspective will become more important than anything else.

Here are some data of great interest. What occurred during the seven years from 1922 to 1929? Stock prices, which started at a level of $75 for the Dow Jones Industrial Average in 1922, increased to $381 in 1929.

Now, 60 years later, what is happening in Japan? Looking at the seven years from 1982 to 1989, we see that the Nikkei average, which started at 7,500 yen in 1982, had reached 38,100 yen by 1989. Is this strange coincidence accidental or inevitable? After the great crash of 1929, America again saw the golden age of the 1950's. What will prove to be the case in Japan?

* Theory Behind Long Period of Cheap Yen

902A0101A Tokyo NIHON KEIZAI SHIMBUN in Japanese 16, 17 Feb 90 Morning Edition—FOR OFFICIAL USE ONLY

[16 Feb 90 p 5]

[Text] A low yen level of $1=Y140 continues. Contemptuous to voices, "It does not follow the economic fundamentals (basic conditions)" that the Japanese currency is weak while its economy is in fine tune and its current balance is in black, there is no indication that the yen will rebound for the time being. Until now, the primary cause of this phenomenon was considered to be the clouds on the political horizon in Japan, and pressing conditions in the Soviet Union and East Europe. However, today, the view is speading that the low yen stems from structural reasons.

Foreign exchange dealers are saying in chorus: "If you watch the supply and demand of yen and dollars in the market, you will see that the yen is on a declining curve." In the exchange market, increasingly yen is being sold to buy dollars and European currencies. The basic low yen tone was correctly forecast by dealers sensitive to market trends.

The eyes of the market-related people are fixed on "when Sony buys dollars." Sony planned to pay for the purchasing cost of the American company, Columbia Pictures, by issuing corporate bonds totaling Y400 billion, and the payment due date was the 14th. It would not be strange if Sony bought Y400 billion worth of dollars after the 15th. There is also the purchase of the American Rockefeller Center by Mitsubishi Estate. Mitsubishi is assumed to have exchanged Y120 billion in March in order to send the necessary funds for the purchase in dollars.

The dollar is demanded not only by large accounts. The recent exchange market is characterized by "small purchasing orders for dollars coming in like fine early summer rain from branches in various districts," (Sanwa Bank). By compounding these yen-selling and dollar-buying demands, "Almost everyday we sense a shortage of dollars by $200-300 million in the Tokyo market," (the Bank of Japan).

In the background of this phenomenon, there is dollar-purchasing by medium and small businesses and individual customers. No longer are large businesses the only ones to monopolize building factories and buying businesses overseas. Individual people purchase overseas condominiums and second houses, and overseas real estate is actively sold to individuals. Among wealthy men, an increasing number of people are said to pursue international diversification of their financial assets. Of those, investments in Europe, headed by West German stocks, are outstanding.

The FY89 direct foreign investment is estimated to reach $60 billion, almost equivalent to a one year trade surplus. This type of investment is a long-term commitment. Yen is sold and foreign currencies are purchased instead. In the case of foreign bond investment, foreign currencies are purchased to pay for the bonds while dollars are sold in the futures market. However, direct foreign investment is independent of manipulative activities such as this and can greatly affect the supply and demand of the exchange market.

The chief economist, D. Hale, of Kemper Financials Services of America analyzed: "About three-quarters of the American foreign debt is financed by business takeovers and capital inflow through stock investments associated with diversification." In the past, the main American investment from Japan was, for instance, the purchasing of U.S. treasury bonds by life insurance companies. Since 1989, that structure is changing, according to a keen observer.

Problems with the takeovers in the United States and direct and diversification investments are the price and investment efficiency or political judgement of economic friction, etc. Since the real estate price in Japan is sky-rocketing, "overseas properties appear extremely inexpensive when converting the yen at a rate of $1=Y140," (Bank of Tokyo). Also, in cases of building overseas factories, many projects can turn profitable if the exchange rate is at the level of Y140. "Converting the price of foreign assets and goods to yen, the yen is still too high, even at the level of $1=Y140" asserts a market-related source.

"The age of 100,000 overseas travelers" is also behind the structural low yen. According to the survey conducted by JTB (Japan Travel Bureau) last month, overseas traveling expenditure per capita reached Y450,000. The FY89 travel balance is a $1.3 billion deficit, exceeding 3 percent of the current surplus. The travel

pattern has not appeared to change. This type of dollar purchasing demand can no longer be neglected.

Minoru Yoshida, director for foreign exchange and securities of City Bank emphasizes: "Last year's low-yen and high dollar market was realized not because America was attractive and the dollar went up but because the yen became weak." The supply and demand balance in the market has changed, creating a rising structural low-yen and high-dollar pressure.

"Politics is also one of the key fundamentals that determines the foreign exchange market," Fuji Bank states as one argument. In the violently active world political scenes where both Germanies are rapidly working toward unification, Japan gives an impression of being left behind. Is it true that "the today's yen has lost its brilliance from economic and political points of view?" as remarked by Senior Vice President Shigeru Nakayama of the First Interstate Bank.

[17 Feb 90 p 4]

[Text] "Stock investors will sell the stock of companies having a reduced profit even if their earnings are in the black whereas they will buy those stocks with improved profits even if their earnings are in the red." Kaneji Ueda, director for the international investments of Tokyo Kaijo Kasai Hoken asserted. He continued that for "at least the next half a year, the low-yen and high-dollar trend will be maintained" based on the recent contrasting movements in the international balance of payments of Japan and the United States.

Japan's current surplus of $7,255 million as of February of last year was halved to $3,818 million by December. The surplus for the entire year 1989 fell below $60 billion, two-thirds of the peak year, 1987. On the other hand, the margin of the U.S. deficit is shrinking although a deficit is still recorded in the current balance. The 1989 trade deficit was also reduced by 8.4 percent compared to the previous year.

The greatest news from which we can dispute the low-yen and high-dollar theory are the reduced interest spread between the United States and Japan. However, Director Ueda takes a completely opposite position: "Bonds of a country highly expected to reduce its interest rates such as the United States will be purchased because of the prospect of a price increase. The shrinking interest spread is what drives the dollar up." He concludes with the claim, "Dollars are not necessarily sold because the interest spread shrinks."

"Japan's economy which is vulnerable to crude oil" is one reason behind the low-yen and high-dollar theory. The oil producing countries which learned a hard lesson from the past crude oil price plunge have restored unity under the leadership of Saudi Arabia, and are seeking to avoid an over-supply market. "This will not immediately lead to a third oil shock, but the crude oil price which has risen to the $22/barrel level will go still higher. The possibility of exceeding $25 and nearing $30 will be a reality by 1995." (Kazuaki Harada, managing director of Sanwa Sogo Kenkyujo). The scenario reads that the fragile yen of Japan which depends practically 100 percent on imported crude oil will be sold for dollars in terms of the medium range outlook.

According to an emerging opinion, the American economic and social structure is changing, which is expected to produce high-dollar factors. The oldest group of the American baby-boom generation is now 44 years old, while five years ago the bulge of this generation was in their thirties. A consumer generation is being transformed into a saving generation.

According to Hiroshi Ohumi, an executive of Myoko Securities, the American savings rate now moves in tandem with the dollar market ever since the introduction of the floating system in 1973. At the initial period when the individual savings rate was around 9 percent, the rate was $1.00=the upper half of the Y200's. However, with the declining savings rate, the market moved to a low-dollar. In 1987, the savings rate plunged to only 3 percent or so, and the high-yen and low-dollar peak came in the following year. Inversely, the market shifted to a low-yen and high-dollar in 1989 and the savings rate recovered to the 5 percent level.

The aging of the baby boom generation into middle age and older will support the claim that, "an increase of the individual savings rate will continue in the future and will work to raise the value of the dollar through improvement of the twin deficits, the fiscal deficit and the trade deficit," (Ohumi). The American disposition to over consume will be turned around, and this will contribute to a reduction of the trade deficit as well as balancing the social security insurance funds since this generation is now paying on its peak earnings. According to this scenario, the aging of the baby boomers also contributes to a reduction of the fiscal deficit.

Kozo Nogami, director for international investments of Nihon Seimei Hoken points out that "the theory of purchasing power parity" is still viable and the strength or weakness of currencies is determined by comparing the price level. He says, "Since the Plaza Accord of 1985, artificial rate setting was promoted in the name of correcting the trade imbalance, driving the yen up above its purchasing power. The poor domestic purchasing power of the yen is rather a problem even from the aspect of the price differential at home and abroad." Regardless of the high yen binge which advanced the yen to the level of $1.00=Y121 in October of 1988, he predicts that "the basic low-yen scenario since then is a reaction to that, and correction of the radical high yen swing will still continue as a mid-range prospect."

Supposing that "the exchange rate is influenced by the forecasts such as the reading of the future by the institutional investors who are involved in huge overseas investments," (Harada, managing director of Sanwa

Sogo Kenkyujo) these institutional investors' view might perhaps affect the future exchange market as low-yen and high-dollar pressure.

*** Examining Rapid 'Export of Capital'**

*** U.S. Views Weak Dollar**

902A0097A Tokyo KINYU ZAISEI JIJYO in Japanese 22 Jan 90 pp 22-23—FOR OFFICIAL USE ONLY

[Interview with Norimichi Oba, International Financial Information Center managing director, by KINYU ZAISEI JIJYO chief editor Tsuchida; date and place not given; first two paragraphs are Tsuchida's introduction]

[Text]The Council on Foreign Exchange and Other Transactions is studying the proper nature of "export of capital" with a completion target of two years from now.

For the past two years I have been expressing the concern that "a weak dollar will lead to the selling of America at bargain prices." For the past year debate on the relationship of the exchange rate and the buying of U.S. assets appears to have taken hold more deeply in America too.

The Strong Yen and Avoidance of Trade Friction

[Tsuchida] Overseas direct investment has increased rapidly; would you care to comment on that?

[Oba] There are a number of causes behind the rapid increase, but the primary one lies in the strong yen since the Plaza Accord and the fact that the size of the surplus in the balance of the current account has progressed at a high level. Furthermore, one can cite the fact that because trade friction had intensified, in the 1980's centered on manufacturing industries there was a shift from export to local production in order to avoid trade friction.

[Tsuchida] When looking at the relationship of the foreign credit and foreign debt of Japan and America, there are some who believe that in the mid-1990's Japan's foreign credit will be $720 billion, and that America's foreign debt will be $1.3 trillion. What is your view?

[Oba] It is certainly probable that America's debt will exceed $1 trillion. But even so, it is said to be manageable for America. Because it does not amount to even 20 percent of America's GNP. But there are those who say that it will be something to worry about if the debt exceeds this figure of 20 percent.

However, this kind of prediction, too, cannot be gauged 5 years from now. It is not even clear what will become of the price of oil. For example, we must also consider what would be done about the financing of America's deficit, and what would be done about providing funds to developing nations, if there was a change in Japan's surplus because of the price of oil, and there are all sorts of views concerning this too. There are some who say that such things are groundless fears. But I think it is necessary to also take such things into consideration.

[Tsuchida] What is the motive for overseas direct investment?

[Oba] A company has no motive for direct investment other than "profit." And this means that companies which excel in technological strength, management ability and ability to raise funds can carry on overseas direct investment. As to how overseas direct investment contributes to the partner country, if we give the example of America, it is possible to cite such things as creation of employment, regional development, transfer of technology, satisfaction of consumer demand and a good influence on macroeconomic policy. Among these I pay attention above all to "creation of employment," so I hope that overseas direct investment will turn toward nations with accumulated debt.

[Tsuchida] But in point of fact the density of direct investment in America is overwhelmingly high. How do you explain that?

[Oba] Insofar as the motive is "profit," that is probably natural. Because with America the risk is far less and the opportunities to make money are far greater than with those countries. But if it is done toward nations with accumulated debt, employment will be created, the rate of economic growth will be increased, political stability will be promoted, and it will become a benign cycle which will generate the next overseas direct investment. Could not the path be opened up by this means to solving of the problem of countries with accumulated debt?

Of course, if one allows things to take their natural course, it is inconceivable that capital will go in the direction in which one wishes it to flow.

The Weak Dollar Put It on Sale at Bargain Prices

[Tsuchida] In direct investment in America, the rapid rise in real estate investment is attracting interest in various aspects. What are your thoughts on it?

[Oba] In regard to real estate investment too, it is probably because it is more attractive in America than in Japan. One factor in that is the strong yen, and speaking from the experience of having participated in the Plaza Accord of 1985, although at the time we had the perception that a change to a "weak dollar" would help in improving the Japan-U.S. balance of trade, there was not that much awareness that it would lead to the sale of U.S. assets at bargain prices.

But beginning 2 years ago I expressed the concern that "a weak dollar will lead to selling of America at bargain prices." Following that, beginning 1 year ago, the debate on the relationship of the exchange rate and the buying of U.S. assets appears to have become a deeper concern of America too.

Of course, when one actually compares the amount of real estate purchased, the amount of money flowing in

from Canada is greater than that from Japan. But that from Japan attracts more attention. This is partly because Japan buys more conspicuous things, and when Japan does something it is taken up in the media. Japan should probably avoid concentrated torrential buying in specific areas.

[Tsuchida] A sudden increase in M&A (mergers and acquisitions) has also become an important recent special characteristic along with real estate investment. What is your view on that?

[Oba] It is said that the situation has become such that now mergers and acqusitions do not succeed without the financial power of Japanese banks. But I suspect that in that situation the fact that LBO's [leveraged buyouts] have lost their former vigor, and their evils have come to be noticed, is because America's rate of economic growth has slowed down.

LBO's are things in which profit is produced with the purchasing company growing at a rapid rate after the buyout, but flaws become apparent when that assumption breaks down. People will probably have to exercise caution in regard to future LBO's.

Companies Have the Ability To Cope

[Tsuchida] It appears to me that in surveying future direct investment one cannot overlook trends in Europe and the EC; would you care to comment on that?

[Oba] I suspect that for the most part companies' responses to the EC integration of 1992 are completed. The problem lies in Europe in the larger sense, which includes Eastern Europe. In Hungary and other Eastern European countries activity by American companies has begun smoothly. It could almost be said that now in America both companies and private-sector banks feel the greatest attraction for Eastern Europe. But Japan is distant from Eastern Europe, and it also has little in the way of personal ties with the people there. Nor does it have any special record of accomplishment there. Yet if Japan abandons Eastern Europe it will end up with only advanced countries, ASEAN and the newly industrialized economic societies [NIES]. It is a difficult matter.

[Tsuchida] The Council on Foreign Exchange and Other Transactions is grappling with this problem; would you comment on that?

[Oba] In the "Special Subcommittee on Problems in International Financial Transactions," which I chair, we have been continuing deliberations on "problems involving export of Japanese capital" since the autumn of 1989. We are beginning by first grasping and analyzing such things as the scope and nature of the outflow of Japanese capital. We hope to be able to make some suggestion or proposal or other in the future, and wish to push ahead with deliberations with a target date of 2 years from now.

Furthermore, I think that we will also pause in the middle and summarize the deliberations in an interim fashion. This is because the movement is rapid in this kind of topic, so it is difficult to forecast with certainty what will become of the framework. Japan's revenues and expenditures move with particular rapidity, once they start.

I, myself, feel doubt on the point of whether Japan's large surplus will continue throughout the 1990's. I would like to debate this point thoroughly. Because the story will end up changing completely if the background to Japan's strength declines.

Furthermore, I think that the balance of the current account moves according to political policy. For example, if we look at the automobile industry, it will have the effect of reducing Japan's surplus by $10 billion by 1992 by active expansion of operations overseas. Will not the balance of saving and investment also change greatly if this happens?

[Tsuchida] What do you think about overseas criticism of Japanese direct investment?

[Oba] I am optimistic concerning this aspect. If the Japanese actually live there for a long time, they begin to understand what is best to do. It will be all right if they keep the good part and go on responding to what is sought by the society. Japanese companies have a great capacity for coping with this kind of adjustment.

* Strategic Overseas Investment

902A0097B Tokyo KINYU ZAISEI JIJYO in Japanese 22 Jan 90 pp 24-26—FOR OFFICIAL USE ONLY

[Article by Taisho Marine Foundation Research Institute research division chief and head researcher, Makoto Sakurai]

[Text] *From about the middle of the 1980's Japanese overseas direct investment has shown growth of about $10 billion each fiscal year, and now Japan has become the largest overseas direct investor in the world. This kind of expansion of Japan's overseas direct investment is not merely an expansion; a conspicuous change has come about in its content, too, so it possesses a pattern and characteristics which differ greatly from those of the 1970's and up to the early 1980's. In this article I would like to arrange and classify the recent characteristics of Japanese overseas direct investment, and at the same time undertake some examination of that aspect which has attracted most attention of late, investment in advanced countries by financial institutions.*

The Metamorphosis of Overseas Direct Investment

Japanese overseas direct investment reached all of $47 billion in FY88. If we consider that from the end of the 1970's to the beginning of the 1980's the total amount of overseas direct investment for each fiscal year was about $5 billion, and that even after entering the 1980's the amount of investment progressed on the $10 billion level

for each fiscal year up to 1985, it will be clear just how conspicuous the increase was after FY85.

Therefore, before arranging and classifying the recent trends in Japanese direct overseas investment, I will list for the sake of reference the characteristics of Japan's overseas direct investment up to now.

Characteristics of the Pattern up to Now

One can cite a number of characteristics of Japanese overseas direct investment from the end of the 1970's to the beginning of the 1980's. If we list representative ones from among them, they will probably be the following five points.

First, that among industry types, the weight of manufacturing industries was high compared with the overseas direct investment of other advanced countries, and the weight of resource-related investment was equally high. Second, that a great deal of weight was given to developing countries as regions for investment. Third, that most of the manufacturing industry was directed toward developing countries (concentrated especially on the Asian and Latin American regions), and the content was investment which followed a policy of the developing countries themselves of industrialization to replace imports, so in many cases most of the products were sold on the domestic market of the developing country.

Fourth, that there was a high proportion of overseas direct investment by small and medium size companies. Fifth, that a great deal of investment by such service industries as finance and commerce was made in connection with trade with Japan and overseas direct investment by the manufacturing sector, so one can probably cite the fact that such service sector industries as finance, insurance and commerce did not carry on investment activity as a business independent from its relationship to investment in trade with Japan.

And this kind of characteristic continued from the time that Japanese overseas direct investment began at the end of the 1950's until the end of the 1970's. In the 1980's, especially after the shift to the strong yen in 1985, this kind of conventional pattern in Japanese overseas direct investment underwent a great metamorphosis.

Nine New Characteristics

The new characteristics have a rather broad content, so it is not easy to summarize them, but it appears to me that if we arrange them they come out to be about the following nine points.

The first is probably the fact that the scale of overseas direct investment has become extremely large. As already mentioned, it reached all of $47 billion in FY88. As background to this, in macroeconomic terms one can probably point out the strong yen and the huge surplus in the balance of Japan's current account; and in microeconomic terms one can probably point out that the globalization of Japanese companies has progressed with striking expansion not only of manufacturing industries but also in such fields as finance, insurance and services.

Second, is the fact that as a characteristic by type of industry, the weight of resource-related and manufacturing-industry direct investment has declined radically, and conversely finance and insurance, commerce and real estate have increased their share rapidly. If we take FY88 as an example, if we add together the three industries of finance and insurance, commerce and real estate, their share within overseas direct investment amounted to all of 53.1 percent.

As the third characteristic, one can probably cite a striking change in investment by region. Heretofore most was in developing countries centered on Asia and so on, but after entering the 1980's the share of investment directed toward advanced countries has increased. Behind this there is also the fact that most of finance and insurance, commerce and real estate is investment in advanced countries, but the fact that investment in advanced countries has expanded in manufacturing industries too, in such fields as automobiles, has also become an important factor in that.

In regard to the fourth, one can probably point out a change in the form of investment. Added to such things as the conventional subsidiary company, branch office and newly established subsidiary company, since the latter half of the 1980's there has begun to be a rapid increase in the form of M&A (mergers and acquisitions), and it has become a new important special characteristic. Moreover, it is probably a characteristic that this form of direct investment is particularly numerous in America and the EC.

For the fifth, one can probably cite the fact that the company activities of the Japanese companies themselves have begun to internationalize and globalize. In regard to this one can point out that in contrast to the fact that heretofore, even when carrying out overseas direct investment, companies only considered the relationship with Japan, investment has increased which takes into consideration such things as the economic relationship between third countries. This trend is conspicuous not only in regard to manufacturing industries, but also in regard to service industries.

For the sixth, one can probably cite the fact that direct investment by such financial institutions as finance and insurance companies is beginning to show a unique pattern which differs from that heretofore. Liberalization of finance is progressing in this field, and a trend has begun to emerge strongly in which overseas direct investment is put to practical use from a global viewpoint as a more strategic method of financial institutions.

For the seventh special characteristic, one can probably cite the fact that trade friction has become an important cause of Japan's overseas direct investment, particularly

in manufacturing-industry investment in advanced countries. It can probably be said that on this point manufacturing industry investment directed toward Asia and manufacturing industry investment in advanced countries forms a very interesting contrast.

The eighth is probably the fact that the manufacturing industry investment in Japan's overseas direct investment has come to be related also to changes in the structure of Japan's trade, and to the structure of Japanese industry. This kind of connection has become more important because of the shift to a strong yen after September 1985, and in particular the trade relationship with Asian NIES and the countries of ASEAN is changing in the direction of horizontal specialization and specialization within a company.

What must be pointed out as the ninth is the appearance of new problem points. When Japanese overseas direct investment expanded this rapidly, investment-related friction was also gradually produced. In particular, all sorts of criticism has emerged of the growth of investment in real estate, and the increase in the number of M&A type overseas direct investments. But there are not only these criticisms; there is also favorable evaluation such as a contribution to development of America's economic livelihood, so how to judge it as a whole is not that simple.

As seen above, very interesting important changes can be seen in recent overseas direct investment from Japan.

Therefore, in the following, I will take up and undertake to discuss direct investment of financial institutions, which is one of the important characteristics of this kind.

Direct Investment of Financial Institutions

Behind the Rapid Increase Lies the Development of Liberalization

As the things that can be considered to be the background to overseas direct investment by Japanese financial institutions, one can probably cite the trend toward financial liberalization centered on reform of the financial system and reconsideration of regulations. In Japan, reform of the financial system centered on banks and securities is a matter of the greatest interest to every financial institution, and this kind of financial liberalization has become one of the important factors which activated overseas direct investment.

Furthermore, the fact that, because of the strong yen, the scale of assets of Japanese financial institutions has become very large when viewed in international terms, has also become a factor which activated direct overseas investment.

To financial institutions, the liberalization of finance means expansion and differentiation into fields other than their business field up to now, so the question of how to absorb the know how of different business fields begins to become important. Consequently, it is probably natural that a tendency will grow strong for each financial institution to try to absorb know-how related to this kind of new business field by direct overseas investment.

It is already well known that one of the tasks for financial institutions within financial liberalization is pursuit, not only of "economy of scale," but also of "economy of scope." In recent direct overseas investment by Japanese financial institutions there have come to be many cases in which, actually, Japanese financial institutions invested seeking "economy of scope" in order to cover or strengthen their own weak points, so it can probably be said that it has the characteristic of strategic overseas direct investment for the sake of Japanese financial institutions themselves.

M&A and Provision of Capital Are on an Upward Trend

In regard to the fact that overseas direct investment by Japanese financial institutions has emerged from a background of liberalization and globalization of finance, naturally a certain pattern is observed also in the characteristics and form of that expansion of operations overseas.

The special characteristic of the expansion is the fact that there is a strong tendency to attempt to compensate by overseas direct investment for what are considered to be weak points when compared with other financial institutions in Japan. For instance, if in the basic finance-industry business of raising and investing capital one or the other is weak, there are many cases in which the strengthening of the weak business will be supplemented by overseas direct investment. For instance, a typical example would probably be such things as buying up a financial institution that is carrying on a superiod fund-raising business in America and so on if the business of raising funds in Japan is comparatively weak.

On the other hand, a financial institution whose investment business is relatively weak in Japan would probably carry out the kind of direct investment in which it buys up overseas a financial institution whose investment business is stronger. This kind of direct overseas investment in the aspect of raising funds and investing, which is the basic business of finance, is not pursuing "economy of scope"; rather the side of pursuing "economy of scale" is stronger, so not only with overseas investment, but in Japan as well, it is probably also carried out through reorganization in the same business field, as in the merger of the Mitsubishi Bank, Ltd. and the Taiyo Kobe Bank, Ltd.

Another overseas direct investment by Japanese financial institutions that can be cited as a typical example is investment of the type which really pursues "economy of scope." This case is one in which the financial institutions carry out overseas direct investment not in the same business field, but in a different financial business field; such things as the purchase by a Japanese city bank

of a "certified dealer" of U.S. Government securities can probably be called a typical example of accumulation of security business know how. Furthermore, the investment of capital (acquisition of stock) in a U.S. investment bank by a life insurance company is also the same kind of activity.

There has begun to be an increase in the amount of direct overseas investment by financial institutions which takes the form of M&A and investment of capital in existing enterprises. This can probably be said to be natural if we consider it from the fact that direct overseas investment by financial institutions is being carried out for the motives of supplementing their own weak points and pursuing "economy of scope." That is, by means of M&A or investment of capital it is possible to accumulate in a very short time functions and know-how which the financial institution does not possess or in which it is relatively weak. If it were to accumulate this know how, not by M&A, but by establishing a new enterprise, it would require more time to acquire that know-how; and doubtless the cost would also be higher.

If one considers the basic trend and background of financial liberalization, it is to be expected that overseas direct investment by Japanese financial institutions will continue its expansion in the future as well. Furthermore, expansion of this trend will be anticipated not only toward America, but also toward the EC. In regard to the EC in particular, it will also become involved with the 1992 market integration, so it appears to me that it may very well expand still more.

There Are Also Voices Concerned About Investment Friction

What must be pondered at this point as a problem for the future is probably the fact that the expansion of overseas direct investment by financial institutions is gradually becoming an object of investment friction in the recipient countries.

Such persons as, for example, President Corrigan of the Federal Reserve Bank of New York have also made statements which are concerned about expansion of the presence of Japanese financial institutions in America, and it is also true that behind it lies the fact that there is a strong perception that although relaxation of regulations and liberalization have progressed in Japan's financial markets, such development is still inadequate when viewed from other advanced countries.

Consequently, liberalization of finance and relaxation of regulations continues to be an important task within Japan too, so the tackling of it in a positive way is also desired in regard to coping with investment friction caused by overseas direct investment of financial institutions.

* Investing in Real Estate

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[Article by Mitsui Trust & Banking international examination division deputy chief, Sadao Iwada: "Toward Expanding Both the Quality and Quantity of Overseas Real Estate Investment—Conspicuous Diversification of Forms of Investment"]

[Text] *There are two fields of overseas investment in which trust banks take part: "investment in securities" and "investment in real estate." In this article I would like to focus mainly on the latter, and to approach the role related to overseas investment of trust banks from the side of the overseas situation on the composition of all sorts of partnerships and situation on development of products in which real estate is broken up into smaller units.*

Rapid Growth From 1986 Onward

According to "Trust Banks in Japan 1989 Statistics" [book title given in English] and "Japanese Trust Companies (1989 edition)," which were published by the Trust Company Association of Japan, the total balance of money loaned by its member banks (excluding the calculation of special international transactions), taking abundant long-term stable capital as the source capital, had reached over Y48 trillion at the end of FY88, having actually increased by 47 percent in the space of 4 years. In addition to providing such things as plant and equipment capital and long-term operating capital for everything from basic industries to service industries, these loans are also being used widely for such things as home loans, trade finance and overseas investment finance. It is impossible to specify the figure within this which is related to overseas investment, but it is probably easily inferred that its weight is increasing of late.

Furthermore, if we take a look at the balance of investment finance in the international sector, at the end of FY88 the balance of foreign currency assets was approximately something over $259.2 billion (equivalent to approximately Y36 trillion), and the balance of yen investment finance directed overseas was over Y5 trillion; judging from the fact that in 2 years they had increased by almost 40 and 60 percent respectively, it can probably be said that in this aspect, too, it contributed greatly in connection with overseas investment.

The coefficient connected with real estate within that connected with overseas investment cannot be specified because of limitations of the statistics, but there is no doubt that it occupies a big proportion.

If we take America as an example, up to about 1985 the amount of overseas real estate investment centered on life and non-life insurance, the construction industry and the real estate industry fluctuated in a stable manner at a base of $1 billion to $2 billion a year, but from 1986 onward it began to increase rapidly, reaching about $6 billion in 1986, about $15 billion in 1987 and over about $18 billion in 1988.

As the background to this, one can cite such things as a decrease in the yield from domestic items and the increase in reserve power for secured borrowing because of the sudden sharp rise in domestic land prices, the feeling that overseas items were inexpensive because of the strong yen, the leveling off of receipt of orders for domestic construction and aiming at an effect of cutting down on taxes. This is the time when such things as Mitsui Real Estate Development Co., Ltd.'s purchase of the Exxon Building and Shuwa's purchase of the Arco Plaza Building filled the pages of newspapers.

Forms of Investment Are Becoming Diverse

The following four points can be cited as special characteristics of this period:

(1) Diversification of the Items in Which Investments Are Made

Formerly the objects of investment were mainly such housing systems as condominiums, but they have gradually broadened to encompass office buildings, and even more composite-type commercial facilities.

(2) Changes in the Class of Investor

From being the exclusive concern of large financial institutions which make large-scale purchases, there has come to be participation by small and medium real estate companies, and because of changes in the form of investment, and in particular because of participation in real estate investment through partnerships, it has gradually expanded to trading companies, leasing companies, manufacturer-affiliated finance companies, and in recent times even to individuals.

(3) Diversification of Forms of Investment

In such things as the aforementioned purchase of the Exxon Building by Mitsui Real Estate, the main form of investment was direct investment. However, the needs of the entrepreneur, who wants to procure funds for purchase and construction of real estate from various sources, and the needs of the investor, who aims at diversification of the objects of investment, go hand in hand, so the form of investment has also gradually diversified into such things as syndication of real estate investment by partnership and the change of real estate debt (debentures) into securities.

(4) Changes in the Investment Objective

Formerly the objective of investment was mainly pure investment, which aimed at yield and capital gains. In contrast to this, in recent times, in addition to pure investment, new types of overseas real estate investment have also been increasing steadily. To be precise, there are such things as cases of purchase of articles for the purpose of acquiring know-how by companies aiming at expanding into the leisure industry or into industries dealing with senior citizens; cases of such things as pension funds and health insurance groups acquiring rest homes and hospices for the prosperity and welfare of their members; cases of individuals purchasing villas and condominiums overseas aiming at enriching free time and life after retirement and cases of schools acquiring overseas laboratories with the aim of enriching their curricula.

As factors in the increase of this new type of overseas real estate investment, just as in the pure investment type of investment, one can cite, in addition to the sense that domestic real estate prices are comparatively high, such things as a change in the consciousness of Japanese accompanying an increase in free time (if we take resorts as an example, a shift from short stays to longer stays), a feeling of dissatisfaction with domestic facilities and a lessening of feeling of resistance toward foreign countries (an increase in overseas travel, the the normalization of overseas business trips and working overseas accompanying the internationalization of business).

It is thought that this kind of overseas real estate investment will also go on expanding in the future in both quality and quantity by the introduction of such things as investment forms based on partnerships.

This arrangement, itself, of syndication by partnership, did not necessarily utilize the Japanese system of trust law. Nevertheless, as specialized financial institutions which give full play in a comprehensive manner to the property-management function on the side of management and investment of property, and the long-term finance function of bearing the responsibility of stable provision of funds, trust banks have responded to clients' needs, which are becoming more advanced and more diverse, by striving to provide products which make full use of the specialized nature and diversified nature of trusts, broker domestic and overseas real estate and expand property consultant business.

I think that this kind of delicate response to the needs of customers has led to scouting out investors, and has also led to expansion of the investor class.

Consequently, judging from the fact that syndication of partnerships by trust banks will not be something based on transitory sales in the future either, steady development can probably be anticipated.

Dividing into Shares Increases the Advantages

As the special characteristic of investment psychology in cases of the aforementioned kind of joint investment items, one can cite the fact that the motive of dispersing the risk of the amount of money invested and the object of investment operates very strongly. Of course it also depends on the balance between the investment item, itself, and the amount of money, but if it is an item of a certain size, it appears that the larger the enterprise the stronger the tendency.

In addition to the partnership syndication mentioned above, trust banks are obtaining rave reviews by utilizing the mechanism of the real estate trust, to develop, with such sellers as real estate companies, products divided

into shares, which further increase the advantage to the investor and the entrepreneur, in order to respond to the needs of a wide range of investors, not only those of large companies.

There are the following two kinds of basic mechanism:

(1) The Joint Equity Trust Method

Investors each receive a common-equity unit of land and building on the level of Y100 million from the seller, and entrust it to the trust bank. This property in trust is leased collectively to the seller, which is a real estate company, and is further subleased to the tenants. The trust bank deducts such things as public taxes and public imposts, a trust fee and a reserve fund for repairs from the rent received from the real estate company, which is the collective lessee, and divides the remaining amount among the investors. It is an example in which after 10 or 15 years, for instance, the trust bank sells off the land and buildings to a third party at the current price and divides the money among the investors in proportion to their equity.

(2) The Voluntary Cooperative Method

It is a method in which investors form a voluntary cooperative according to civil law by each investor investing capital in the joint equity which he has purchased, and that voluntary cooperative joins the real estate together and entrusts it to a trust bank.

This method was born from the concept of partnership based on U.S. real estate investment, but it bundles together the joint equity rights which have become scattered, so it facilitates centralized decisionmaking on the management of the leasing business and the time for disposing of the property in the future.

Moreover, recently, trust banks are also devising ingenious plans in regard to subdivided items in which domestic items, for which the yield is low but capital gain is anticipated, and U.S. items, for which the yield is comparitively high and which also have great advantage in disposal, are combined into sets.

Thus, such advantages as expansion of the scope of investment objects, such as large buildings, reduction of work on the management side by the trust method, and resolution of uneasiness on the aspect of maintenance are gained for the investor; moreover, for the entrepreneur as well, there is the advantage of expansion of the range of choice of development and sales method. These depend to a great extent on accumulation of a trust bank's intricately detailed know-how, so we can probably anticipate a steady increase in the future as well.

* Attractive Investment Market

90JA0097D Tokyo KINYU ZAISEI JIJYO in Japanese 22 Jan 90 pp 30-33—FOR OFFICIAL USE ONLY

[Roundtable discussion with New York office chiefs of Japan Life Insurance, Hideichiro Kobayashi (A); First Life, Takahide Nakagawa (B); Sumitomo Life, Shuichi Wakida (C); and Yasuda Life, Kunio Hoda (D); moderated by New York office chief Ryutoku Mizuno of the Association for Research on Financial and Government Finance Affairs]

[Text] **The Scope, Diversity and Qualitative Depth of a Highly Attractive Investment Market; Roundtable Discussion With Representatives of Life Insurance Bases in America; Stock Investment Should be Localized**

Investment in America by Japanese life insurance companies has reached a vast amount in the securities and real estate fields. Wherein does the necessity for that lie, and what are the problems which are produced from it? Furthermore, what kind of improvement of the system will be sought in the future for the life insurance companies, which are the main investors? We had four people from major life insurance companies, who pursue their calling in New York on the front line of business, discuss these points.

As Lubricating Oil for Raising the Bottom of the U.S. Economy

[Mizuno] In recent years, investment by life insurance companies has come to attract a great deal of attention in America.

A: To begin with, behind the expansion of operations to America by life insurance companies there is the problem of where to invest surplus funds in Japan, the existence of the domestic-foreign interest differential and the dispersal of assets, including such things as countermeasures against earthquakes.

Whether it be stocks or bonds, America is the world's largest market along with Japan. Liquidity is high, and it has deep pockets. Furthermore, it is an innovative market. New ways of thinking are all borne out of America. It is still the center of international politics and economy, so information comes together from all over the world. When investing overseas, it would be inconceivable to exclude America. We expanded operations here because investment in America is the most important point in overseas investment, and we think that it will go on growing in the future as well.

B: Speaking realistically, I think that the investment in stock in America which comes from the kind of perception that you just expressed does not, of itself, have that much friction with foreign countries.

On the other hand, in regard to real estate it is direct investment, morover there is also the fact that it is visible, so it is probably true that it has become sensitive in various ways. But speaking from our viewpoint, life insurance companies are also investing in real estate very cautiously. We are trying to disperse it in terms of region, and are also assessing the price very cautiously. The view that the sudden sharp rise in the price of land and buildings is caused by investment by life insurance companies is not held in America. Rather, in the recent

market, I wonder if it should not be viewed as caused by the fact that U.S. and European pension funds and the like are investing in a very active manner.

In this kind of sense, the people in U.S. real estate industry circles have a good understanding of real estate investment by life insurance companies. Better still, the situation is such that they welcome ourinvesting in a stable manner. It appears that there is strong interest in direct investment, but I think at present there is nothing which influences behavior as a problem which is really urgent.

C: I feel the same way. We are being allowed to do business in America, so we are not in a position to talk big, but if we invest money the seller of the real estate uses the money gained to invest again. It seems to me that there is prooably no one who allows the money to sleep in a bank account. Consequently, I think our investment in real estate has been passed along to an increase in U.S. employment through circulation of capital. I feel that we are bearing a share of a role like lubricating oil which leads to raising the bottom of the U.S. economy.

[Mizuno] Are there any reasons for investment by life insurance companies to be controlled?

B: I cannot think of any in regard to securities. If one really considers the financing of America's budget deficit, the buying of government securities by Japanese investors in general, not only insurance companies, should be welcomed by America. To control it would, conversely, mean raising U.S. interest rates, so it would be of no benefit whatsoever to America.

C: It will probably be a bit different if we begin to feel that we have had our fill. At apresent we are carrying on diverse investment all over the world, and are trying very hard to disperse assets even in the aspect of currency. Even so, the greatest weight rests on Japan and North America. Therefore, it may change if we reach a state of saturation as the result of money having flowed in repeatedly when American interests rates were relatively high.

The reason why the provision of capital for LBO's [leveraged buyouts] by banks is being regulated is probably partly because of a judgment of the risk, but I think it also fulfilled a fixed sense of how far one can invest in what.

The Greatest Motive Lies in the U.S.-Japan Interest Differential

[Mizuno] More than 10 years have passed since Japanese life insurance companies started operating in New York; has there been any change in your aims during this time?

B: The interest differential between Japan and America was a big factor in our motive for expanding operations to here. While, on the one hand, the volume of our capital had grown steadily, it had begun to become impossible to digest all of it just with the avenues for investment available within Japan. Therefore, our attention was attracted to America, which has high interest and the world's largest security market. We actually began full scale investment activity in the early 1980's, but you could say that we came to America for the purpose of investing.

C: The impetus of the expansion of life-insurance capital is certainly very great. For the past few years it has shown double-digit growth each year, and now has become about Y106 trillion. The base is such that it gives one the feeling that it will double in 5 years if it goes on in this way. The fact that investing this much money just in Japan would be a great deal of trouble led to expansion to America. And as to the advantage of having a base here, to be sure our job is to find investment vehicles in a large market, but as I understand it, the meaning of a unit which supports Japanese domestic investment was also very great. Even now, when we find something to invest in we report to headquarters, and information is fed back to us. Translating that into actual practice has also become a main activity in New York.

When I consider what we sought from America when coming here, I think our greatest aim was the absolute size, diversity and qualitative depth of this kind of investment market. In addition, America is a market which one can absolutely not miss in the aspect of advanced, leading edge methods.

I wonder if the fact that life insurance companies have begun investing in foreign countries has not also become a step by which Japanese life insurance companies have come to be recognized on an equal footing with other financial institutions. If we examine the domestic background for expanding internationally, with the limitation of disbursements from income we needed to brance out to where high disbursements could be attained, so inevitably we began to invest in foreign countries with a high interest differential. And there is the trend that disbursements actually rose. At present, too, we have a capacity to absorb funds, and the assets of life insurance companies have grown, and I suspect that one of the things which started it was this kind of overseas investment.

And when one has looked at Europe, Australia and Canada, as one might expect, the one with the big market is America, and the one in which we can invest large amounts of money is also America.

A: On the other hand, if one looks at the situation in Japan, it would probably be a lot of trouble to find investment vehicles in the future as well. In real estate the price of land rose sharply, so it is very difficult to make a profit. And in regard to securities, there is a limitation on the amount held as a ratio of total assets. Of course this has not reached its ceiling, but.... Furthermore, up to now loans made up a large share, but they have already peaked, and the proportion of total assets which they make up has begun to decline.

D: The situation is that loans have fallen below 40 percent.

A: There was also the problem that the company side had begun to be oriented toward direct finance, so when life insurance companies wondered where to invest the money that they had gathered, they began investment in America with the U.S.-Japan interest differential as the main point. Added to that was also the motive of dispersal of assets directed toward earthquake countermeasures and the like.

The Task Is Guaranteeing the Nurturing of Capable Staff

[Mizuno] It appears to me that internationalization will progress still more in the future, but in what manner will it progress? And at what stage do you consider it to be located at present?

D: The internationalization of life insurance can be divided into the internationalization of life insurance business and the internationalization of investment business. In regard to the former, there exists the view that life insurance is something domestic. But among U.S. life insurance companies there are some which have expanded operations worldwide. Japanese life insurance companies are still far behind in this aspect, so they still have a lot to learn.

On the other hand, on the investment side, international dispersed investment will progress further. Such being the case, it means that the staff too must internationalize. The people one uses, the management setup, the organization and the content of the company, all must go on internationalizing.

One of the problems is the fact that when investing overseas it is probably necessary to progress in the direction of becoming independent in the position of an indigenous company. Consequently, it is probably also necessary to actively hire local people. I wonder if our present situation is not one of we, too, finally beginning to experience bit by bit the problems which Japanese manufacturers have had difficulty with.

A: As one might expect, as long as we have come to America and are carrying on investment activity, we will not be able to be accepted unless we go on adopting an Americanized way of thinking or mode of behavior. If we insist on sticking strictly to the Japanese way of doing things there will be all sorts of limitations, so it will be difficult.

C: In the internationalization of life insurance business, there is the side of adapting to the overseas expansion of Japanese companies, and contributing to the convenience of clients overseas, too, as an extension of domestic operations. In the future, it will probably come in stages, but I suspect that we will be undertaking in our own way to insure U.S. companies. It is probably a topic for the future, but we may expand to mergers with and acquisitions of U.S. insurance companies, and joint ventures.

In regard to investment, I think that the staff will have to expect to stay in America for a fixed number of years. I think that 1 or 2 years is too short to become acclimatized, and to be able to work on an equal footing when dealing with American pros. Furthermore, in order to get excellent Americans to work for us, we will have to make it into an attractive place to work. I suspect that internationalization is something in which one must go through such stages before advancing.

A: In regard to the Japanese staff, while, on the one hand, they have to accumulate experience, we also have to increase their number. If the stay of each staff member gets longer, their number will not increase as a stratum in the company.

C: What to do about the contradiction between equally necessary principles is truly a taxing problem. Because of the relationship to a visa, the longest stay is 5 years. With that period we guarantee the stratum and increase the accumulation of know-how. This is a never-ending theme.

D: In a business in which the flow of money is too fast, as in the investment business, it is very difficult for us to keep up.

B: Insurance and investment are the two wheels of a car, so the situation of internationalizing centered on investment will probably change in the long view. Even here, the necessity for RM [research memorandum] type service for Japanese companies has increased, so in that sense, too, the environment is being prepared.

Speaking in regard to the internationalization of investment, I sense as a trend the fact that local authority has gradually increased. The local placing of orders by agents has gradually increased. Even in investment in foreign bonds, up to now we were doing it in a fairly dynamic manner in Tokyo, but there is no need for someone who is acting on New York news to trade with utmost effort in Tokyo. To some extent in the New York market I suspect that one can do things on one's lunch hour. With stocks, too, you have to have the local sense of life. It is unreasonable to buy and sell stock by the company's name alone in spite of the fact that you cannot recall what products it is selling. Investment in stock should certainly be localized. I think that decisionmaking will go on gradually being transferred to the overseas local corporation because of this trend.

D: Life insurance is attracting attention on the points of volume of capital and volume of investment, so it has also become material for discussion. Having become aware of this fact, our task in internationalization is probably to go on harmonizing skillfully with American society.

* Globalization of Companies

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[Article by MITI Industrial Policy Bureau International Industry Section acting section chief, Yoshihiro Tamura: "Globalization of Japanese Companies Is Advancing Further—A Strategy of 'Localization' Toward Smooth Development of Overseas Business Activity"]

[Text] Against the background of a strong yen, which originated in the Plaza Accord of September 1985, in recent years overseas direct investment by Japanese companies has been continuing to expand rapidly. In particular, companies have increased which adopt a company strategy from a global perspective which seeks to use management resources effectively on a world scale, so the globalization of Japanese companies has begun to show greater and greater expansion by such things as establishing coherent setups of development, production and sales in major markets of the world, and activation of moves to establish in each major region of the world a general company for that region.

The progress of this kind of globalization of business activities of Japanese companies is something which further deepens the relationship of interdependence of Japan and the world economies and societies, but, on the other hand, there is also concern that friction with local industry and society will be generated accompanying a rapid increase in the Japanese presence in connection with the development of overseas business of Japanese companies.

In the following, I will analyze the current state of this kind of overseas business activity of Japanese companies, centered on manufacturing industries, and then go on to discuss problems which will accompany future globalization of companies (unless special notice is given to the contrary, the data used is based on MITI's [Ministry of International Trade and Industry] "Survey of Trends in the Overseas Business Activities of Japanese Companies").

Rapidly Increasing Overseas Direct Investment

According to the actual results of the Ministry of Finance's reports of overseas direct investment, the amount of Japanese overseas direct investment has been recording great growth in recent years, with $33.4 billion in FY87 (a 49 percent increase over the previous fiscal year), $47.0 billion in FY88 (a 41 percent increase) and $30.8 billion in the first two quarters of FY89 (an increase of 35 percent over the same period in the previous fiscal year).

Looking at it by region, investment in North America is still developing at a high level, accounting for close to approximately 50 percent of all investment, and approximately 20 percent was invested in Europe.

By industry, approximately 70 percent of the $30.8 billion overseas direct investment in the first two quarters of FY89 was invested in non-manufacturing industries. Within that, the share occupied by the finance and insurance industry and the real estate industry was particularly high; investment in the finance and insurance industry was $7.4 billion and that in the real estate industry was $5.9 billion. Moreover the growth in the last few years is also striking. Investment in manufacturing industries has grown rapidly since FY86, so the investment carried out in the period of 3 years and 6 months from April 1986 to the end of September 1989 ($33.7 billion) accounts for about 60 percent of the aggregate total at the end of September 1989 ($58.1 billion). By region, investment in North America accounts for about 60 percent, and shows a high share for the last few years. Furthermore, investment in manufacturing industries in Asia also shows a big increase in recent years.

As of March 1989 there were 7,544 local corporations of Japanese companies developing business activities overseas (with 10 percent or more of their capital provided by the Japanese side), and 3,243 of the companies are manufacturing industries. Furthermore, when we look at the distribution of the time of establishing manufacturing industry local corporations, 1,028 companies, 32 percent of the local corporations established up to now, were established in 1986 or later, so one can infer that companies' development of business overseas became active after the strong yen. The expansion to Asia and North America is particularly striking; over 80 percent of the companies established since FY86 were established in those two regions.

When we look at the form of overseas business activity of manufacturing industries, as of March 1987, 40 percent of the total were newly established companies for which 100 percent of the capital was provided by the Japanese side; 45 percent were newly established joint venture companies, 4 percent were due to buyouts of existing companies and 11 percent were capital participation in existing companies, so newly established companies accounted for approximately over 80 percent of all overseas business activity of Japanese companies. However, in the last few years, added to the M&A boom in America and so on, expansion of operations by M&A centered on America has increased against a background of such things as Japanese companies' strong desire to expand new business and the decline in investment cost because of the strong yen. The M&A by Japanese companies are not hostile, generally most are friendly, and most are cases in which the objective, too, is one in which the M&A is carried out from the viewpoint of securing an overseas base for the company itself based on its international strategy.

Furthermore, up till now in most cases the overseas business activities of Japanese companies were developed by business units, but in recent years, in the course of the rapid development of a company's globalization, the importance of the operations aspect of business

management is increasing, so a trend has become active to establish in each major region of the world a regional control company which is in charge of and manages the local corporations located in that region. This kind of trend is not limited to large companies; it is expanding even to medium size companies.

As seen above, Japan's overseas direct investment has been growing each year, and the overseas business activities of Japanese companies are increasing their economic presence in every part of the world. In the following we will examine the state of this kind of overseas business activity of Japanese companies, centered on manufacturing industries.

Overseas Production Continues to Expand

When we look at the sales trend for Japanese companies' manufacturing industry local corporations, the last few years show a great increase, with FY88 reaching $132.3 billion (an increase of 28 percent over the previous fiscal year). This has reached a scale which is approximately one-fourth that of the sales of the overseas local corporations (manufacturing industries) of U.S. companies.

Furthermore, the ratio of overseas production (sales of manufacturing industry local corporations/sales of all domestic manufacturing industries) rose sharply, with 4.0 percent in FY87 and 4.9 percent in FY88, recording its highest level in history. Moreover, there are signs that FY89 will be 5.8 percent (estimate), breaking the level of FY88.

Looking at it by type of industry, high ratios are being recorded by such industries as electrical machinery, with 10.6, and transport machinery, with 9.4. Furthermore, if we limit it to companies with overseas operations, and look at the ratio of sales of the overseas local corporation to the sales of the headquarters company, it reaches 12.7 percent for manufacturing industries as a whole.

The plant and equipment investment of manufacturing industry local corporations showed a big increase at $12.4 billion in FY88 (an increase of 46.4 percent over the previous fiscal year). Viewing it by region, North America accounted for 49 percent and Asia 34 percent, so it is thought that the active plant and equipment investment in the two regions contributed considerably to maintenance of industrial activity and to economic growth in the two regions.

When we look at the ratio which this amount of plant and equipment investment for overseas local corporations occupies in the amount of plant and equipment investment for all corporations in Japan, it reaches 11.0 percent on a base of all manufacturing industries; when we look at it by type of industry, there are some types of industry which recorded very high ratios: transport machinery with 28.8 percent and iron and steel with 27.5 percent.

For the past 2 years a comparatively high level of plant and equipment investment has been carried out overseas, and latent productive capacity is considered to be accumulating, so it is predicted that this kind of increase in productive capacity will be actualized in the near future, and that overseas production will go on increasing still further.

Exports of manufacturing industry local corporations to Japan (the amount of reverse exports) for FY88 is estimated to have been $9.4 billion (an increase of 3.6 percent over the aprevious fiscal year), and has assumed a scale which accounts for 5.1 percent of all Japanese imports and 10.2 percent of all imports of manufactured goods.

By region, reverse imports from Asia were $5.7 billion, and those from North America were $2.3 billion, so these two regions accounted for 84 percent of all reverse imports. The ratio which reverse imports occupy in the total imports from each region is 9.8 percent for Asia and 4.3 percent for North America, so one can infer that Japanese companies are contributing greatly to the export side of the countries in which they are investing. (reference 3)

The Revenue Situation Is Headed Toward Improvement

At a total ordinary income of $7.3 billion (a 95 percent increase over the previous fiscal year) for manufacturing industry local corporations in FY88, improvement over the previous fiscal year can be seen. The ordinary income per company also increased in all regions and in almost all types of industry, so in FY88 the revenue situation took a turn for the better throughout the world. The ratio of companies with a surplus was 54.9 percent, so over one-half of the companies recorded a profit. Looking at it by region, the regions in which this ratio was high were Central and South America (67.2 percent) and Asia (59.2 percent); conversely, the regions in which it was low were the Middle East (38.5 percent) and North America (40.9 percent).

Furthermore, ordinary income on sales rose greatly from 2.2 percent in FY87 to 2.9 percent in FY88 (reference 4). However, it remains at a low level when compared with the 4.5 percent level of profit of all domestic corporate enterprises, so it can be inferred that there are still many difficulties accompanying management of companies overseas. In particular, the rate of profit of companies immediately after beginning operation is very low; at minus 2.7 percent and minus 1.6 percent respectively, the rate of profit in North America and Europe of companies that began overseas operations in FY86 or later is deep in the red, and in Asia, too, it remains at a low level at 0.8 percent.

As of the end of March 1989, the number of people employed by manufacturing industry local corporations had reached 1 million 53 thousand, breaking the 1 million mark for the first time, so it had become something which was contributing greatly in the aspect of

creation of employment to the economies of the countries in which the investment was made. Looking at it by region, 583,000 were employed in Asia, accounting for 55 percent of the whole, and 215,000 people were employed in North America, accounting for 20 percent of the whole, so it can be inferred that the contribution to creation of employment was especially large in Asia.

As "Good Corporate Citizens"

As has been seen above, the globalization of Japanese enterprises is something which even in the countries which received the investment has contributed to such things as transfer of technology, activation of the economy accompanying transfer of capital, creation of employment and improvement in the trade balance by substitution for imports and promotion of exports, but on the other side of the coin there also exists the possibility of producing all sorts of friction accompanying an increase in cultural and social contact with the country in which the investment is made.

As matters now stand, this kind of "investment friction" has not necessarily reached the point of actualization. Nevertheless, according to a MITI survey it is estimated that the overseas direct investment stock of manufacturing industries will go on expanding till the year 2000 at an annual rate of 16 percent, so if we make a trial calculation of the future rate of overseas production based on this, it is estimated that it will rise from the present 5 percent level to a 13 percent level in the year 2000. In a situation in which it is estimated that the presence of Japanese companies overseas will go on rising rapidly in this way in the future as well, a situation in which this problem is actualized in the future is also fully conceivable.

At present, overseas Japanese companies are actively developing localization in such aspects as the ratio of local procurement, the staff, technology transfer, research and development and efforts toward activities which harmonize with the local society. According to a MITI survey, almost one-half of processing and assembly manufacturing industry businesses that have developed business overseas clear a 66 percent ratio of local procurement (on a value added base), in addition to which, almost one company in four clears the very high local procurement ratio of 80 percent. Furthermore, there are also many companies which are actively grappling with activities to harmonize with the local society: 27 percent of companies are "making donations to various kinds of organizatiors," and over 20 percent of companies are "participating in various kinds of community investment" and "making donations to educational and research facilities."

However, it is also true that overseas business development has progressed rapidly in the last few years, and localization has not advanced to the same extent that the presence of Japanese companies has risen, and it is true that there is seen in some quarters the assessment that "Japanese companies are not enthusiastic about localization." According to a MITI survey, even among Japanese companies, in companies that have been operating overseas for a long time and in large companies, the efforts at activities to harmonize with the local society are gradually spreading, but in companies that have not been operating overseas long and in small companies, the extent of such efforts is not necessarily high.

Consequently, in order for Japanese enterprises to go on expanding overseas business activities smoothly in the future as well, it is important that they give this problem sufficient consideration, and strive, through activities to contribute to and harmonize with the local economy and society, to be accepted as "good corporate citizens" by the local society.

In this situation, in May 1989 a proposal was made in the Industrial Structure Council's recommendation, "the direction of industrial activity and industrial policy under globalization," concerning guidelines for "company activities which are hoped for in developing overseas business" which are necessary in order for Japanese overseas local corporations to promote localization and be accepted as "good corporate citizens," so it is hoped that in the future each company will go on developing overseas business activites smoothly in accordance with the gist of this proposal.

As seen above, it is believed that the overseas business activities of Japanese companies will rapidly realize quantitative expansion in the future as well, but the question of how to advance a strategy of globalization which includes not only a simple economic strategy of optimum distribution of management resources on a world scale, but also a strategy of "localization" in order to be evaluated and accepted as a local company of the region in which one is operating, will probably be a big key to its success or failure.

Company Behavior Hoped for When Developing Overseas Business (10 items):

- 1. To carry out smooth transfer of technology and know how to the country in which the investment is being made.
- 2. To promote in a planned manner the local procurement of parts.
- 3. To actively conduct research and development in the country in which the investment is made.
- 4. To attempt to appoint local people to the managerial level in overseas companies in which investment is made, and to not exercise improper discrimination in hiring, locating or promotion.
- 5. To establish good labor-management relations in overseas companies in which investment is made.
- 6. To fully respect the autonomy of overseas companies in which investment is made.
- 7. To participate actively in planning the solution of problems peculiar to companies in which investment is made.

- 8. To actively conduct such social and cultural activities in the country of investment as volunteer activities and donation activities.
- 9. To give full consideration to environmental problems in the country of investment.
- 10. To not carry out such improper actions as bribery.

(Data) Based on "The Direction of Industrial Activity and Industrial Policy Under Globalization," a recommendation of the Globalization Subcommittee of the Industrial Structure Council (30 May 1989).

• Experts Discuss Monetary Policy Course

902A0092A Tokyo NIHON KEIZAI SHIMBUN in Japanese 6-8 Feb 90—FOR OFFICIAL USE ONLY

[6 Feb 90 p 5]

[Interview with Hiromi Tokuda, Nomura Research Institute managing director; interviewer unidentified, date and place not given; first paragraph NIHON KEIZAI SHIMBUN introduction]

[Text] The outlook for the fourth official rate hike, which was once seen as a strong possibility by financial circles, has become dim partly because the general election campaign has started. On the other hand, reflecting the Soviet situation, etc., foreign exchange, stock, and bond markets have become unstable. We asked financial experts to comment on the monetary policy course in the future.

[NIHON KEIZAI SHIMBUN] How do you read the stock and bond market situation from the beginning of this year?

[Tokuda] I consider that the sudden price decline of Japanese stocks is due to the loss of expected "peace dividends" based on detente between the West and East, etc.

As to the bond market, it is noteworthy that oil money recently started to buy Japanese bonds for the first time in two and a half years. The [illegible]nd price has declined due to the change of international fund flow, resulting in the hike of long-term loan interest rates. The hike may cause a recession in the United States.

[NIHON KEIZAI SHIMBUN] I wonder if the lower yen may cause inflation.

[Tokuda] The current foreign exchange rate is fluctuating according to complex political factors. The interest rate difference between Japan and the United States has been narrowed. The exchange rate does not fluctuate according to the interest rate alone. The quality of management has been strengthened because Japanese companies have taken measures against an economic slowdown caused by the high yen, and have done some restructuring. Besides, their earning levels are high. Active capital investment has created the favorable supply-demand situation and importing has been expanded. Thus, it cannot be said that the lower yen will cause higher product costs.

[NIHON KEIZAI SHIMBUN] Won't the oil price hike and the wage hike obtained during the spring offensive cause inflation?

[Tokuda] Considering the supply-demand situation, I do not foresee any large increase of oil prices. If the wage hike remains within a five percent level, there will be very little concern for inflation. We reckon that 0.5 percent wage increase will cause only 0.14 percent consumer price increase and there is very little possibility for wage inflation.

[NIHON KEIZAI SHIMBUN] Could the land price hike cause inflation?

[Tokuda] Moral suasion has a limitation. There is a need for selective restrictions such as holding the increase ratio of loan amounts for land purchases under that of overall loans. Adopting controls on interest rates will have side effects. To impose limitations only on loans for land purchases is extraordinary but we must pursue it. However, the Bank of Japan may not like it.

[NIHON KEIZAI SHIMBUN] Is the current interest rate level appropriate?

[Tokuda] The current interest rate is at a very high level, equivalent to that of November 1985. Considering the net growth ratio and the expected inflation ratio, the long-term prime rate of 7.5 percent is considered to be too high. This will cause a hike of mortgage loan rates and may affect consumption, which may work against the Japanese economy. As for the official rate, there was a time when it was only 5 percent even while the economy was booming. The effect of raising the official rate will take at least half a year. We already see some preventive effects, but we must carefully watch the accumulated effects of the last three official rate hikes.

[NIHON KEIZAI SHIMBUN] What is important for the future monetary policy course?

[Tokuda] To become the largest creditor nation in the world, it took 100 years for the United Kingdom, 50 years for the United States, and only 5 years for Japan. Therefore, changes of economic and financial systems and policies have not kept pace with the new situation. Funds collected by Japan must be recirculated in the world. The behavior as the largest creditor nation will greatly affect the financial and economic situation of the world. The world is focusing its eyes on Japanese financial policies. The financial policy should be based on a wide perspective. The policing of operations taken by Mr. Mieno, President of Bank of Japan are highly rated. To achieve an overall balance, coordination with the national finance policy is also important.

[7 Feb 90 p 5]

[Interview with Takao Akabane, EPA Consultant; interviewer unidentified; date and place not given]

[Text] [NIHON KEIZAI SHIMBUN] How do you read the decline of bond and stock markets since the beginning of this year?

[Akabane] The international situation in the Soviet Union and Eastern Europe affects the markets a great deal. From the economic aspect, the three hikes of official rates in the last year have finally taken effect. Basically, the bond market reacts against the interest rate changes. Up to now, the supply of government bonds was short because of measures taken by financial institutions for the end of the fiscal year. That made the bond market firm. However, effects of official rate increases have recently become influential. Although there is a special situation in Japan in which companies own each other's stocks, the basic principles for both stocks and for bonds are the same. What should have come down has come down.

[NIHON KEIZAI SHIMBUN] The foreign exchange market has been unstable since the low yen and high dollar situation at the beginning of this year. There is a sign of change in the international fund flow.

[Akabane] As to the foreign exchange market, one should look at it from the viewpoints of investment and speculation. From the viewpoint of investment, the smaller difference in interest rates between Japan and the United States will make the dollar assets less attractive, and this will result in a lower yen and higher dollar. However, from the viewpoint of speculation, even if the interest rate is hiked in Japan, as long as there is an outlook for higher interest rates, no incentive for buying Japanese bonds exists. Conversely, in the United States, lower interest rates were expected, and there was a demand for bonds as a bond price hike was expected. As a result, the process in which Japan has hiked its official rates and the difference in interest rates has become smaller has caused a lower yen and higher dollar. Our feeling is that there will be an end to the hike of interest rates in Japan. Speculative factors are becoming weaker. From the investment viewpoint, the smaller difference in interest rates induces an investment in yen assets. This will cause the trend towards a higher yen and lower dollar. However, there is the factor that the Japanese trade surplus must be decreased. Thus, the force for the higher yen will not be very strong. I suspect that the exchange rate will fluctuate.

[NIHON KEIZAI SHIMBUN] Doesn't the interest rate hike affect the economy?

[Akabane] If the hike stays at the current level, it will not have much affect. The reason why heavy capital investment is being made now is not because the economy is good, but because companies must meet technical changes and new business opportunities. It is based on the mid-term restructuring of industries. I do not consider that it will affect individual consumption soon. Consumption will be affected by an economic situation rather than by the interest rate alone. The cycle of capital investment-economic expansion-consumption expansion-increased earning-capital investment still continues.

[NIHON KEIZAI SHIMBUN] What is your outlook for a price trend?

[Akabane] The biggest domestic factor is wages. If wages are increased at a much higher rate than productivity increases, it causes inflation. In the past 10 years or more, a balance was maintained between the increase ratios of wages and productivity. Although there is the labor shortage factor, the trend in the past 10 years may continue. If the wage increase ratio after the spring offensive stays within the 5 percent level, inflation will be of no concern. We must prevent artificial price hikes caused by producers taking advantage of import price hikes of goods such as oil. However, to suppress the increase of import prices by financial policies should be avoided.

[NIHON KEIZAI SHIMBUN] What is your view on the continued increase of money supply and land prices?

[Akabane] The increase ratio of money supply for last December was in double digits again. However, bank loans will be less active and the increase ratio of money supply will be lowered. In the stock market, the asset increase will cease. There are various factors affecting a land price hike. Monetary expansion will cause a hike. It may be necessary for the government to adopt a tight money policy temporarily, but it will not be a permanent solution. One must understand that the policy has a limitation and an excessive tight money policy may be overkill.

[8 Feb 90 p 5]

[Interview with Kumiharu Shigehara, director, BOJ Monetary Research Institute; interviewer not identified; date and place not given]

[Text] [NIHON KEIZAI SHIMBUN] Should we worry about the influence of the long-term low yen on commodity prices?

[Shigehara] The exchange rate of the yen with the dollar is fluctuating within a certain range, but that of the yen with European currencies especially the mark has come down. Some say that it is caused by the political situation and the interest rate difference in the case of the mark. My view is that it is caused by the steady decrease of the Japanese trade surplus in spite of the general belief that the surplus would expand. However, the question is how markets interpret the J-curve effect (effect of the decreased surplus due to a phenomenon that a decrease of export value precedes an increase of export quantity) and the influence by the slowdown of the U.S. economy. It is wrong if the market does not reflect economic

fundamentals. The fundamental is that the trend is towards a higher yen reflecting the strong Japanese export competitiveness. Compared with the United States and Europe, in Japan the ratios of finished goods and consumer goods imports to the total are smaller. This makes it more unlikely that the exchange rate directly affects the prices. However, a question remains for intermediate products. Whether companies can afford to absorb the increase of import costs is a question. The difference between supply and demand has become narrower. For that matter, it seems that the increase of import cost affects domestic prices more than before.

[NIHON KEIZAI SHIMBUN] What is your opinion on how the oil price increase affects the commodity price?

[Shigehara] In the long-term view, consumers and businesses are cognizant of the need to save energy when the oil price gradually increases. Recently, this need as seen by the Japanese has been diluted. It is necessary to take measures to protect against an oil price rise or a third oil crisis. On the premise that oil prices will gradually rise, prices of things other than oil must come down in order for us to achieve a stability of general prices.

[NIHON KEIZAI SHIMBUN] What is your view on the increase of service cost due to the shortage of labor and the increase of land prices?

[Shigehara] During the period of the latter half of the 1970's to the 1980's, because of lower economic growth, there was not much difference in the productivity increases between service industries and manufacturing industries. However, the difference has become larger as the economy has grown moderately. The cost of service will increase to some extent, and to compensate for that, it is important for overall price stabilization that the price of manufactured goods come down. In that sense, we cannot be satisfied with stabilized wholesale prices. You might say it is merely an extension of policies operating from the 1970's. It is important for us to establish a trend that unit labor costs continue to come down. The violent increase of land prices in the 1970's influenced rentals for land and houses for many years. The current price increase will eventually push consumer prices upwards. The creeping inflation will formulate the basis for wages and prices. In the United States, wages are based on the four percent inflation ratio. And, if the government tries to reduce the inflation ratio to zero by adopting a tight money policy, people must shoulder some burden. To avoid that kind of situation, it is important for us to take preventive measures.

[NIHON KEIZAI SHIMBUN] Do you consider the current speed of economic growth and the level of the long-term interest rates, which have risen since the New Year, appropriate?

[Shigehara] It is hard for me to judge at this time. One of the important points is what is going to happen to the average cost of raising capital for industries including that from low-cost capital markets. As to the money supply, I forecast that it will be at the nine percent level in the January-March period. But, if it surpasses that level, serious measures must be taken.

[NIHON KEIZAI SHIMBUN] Some say that if Japan raises the official rate again, the fund flow into the United States will change and it will cause a hike in long-term interest rates in the United States. This may further cause a slowdown of the economy. What is your view on this?

[Shigehara] There is a forecast that in 1990 the amount of surplus capital in West Germany will exceed that of Japan. There is no need to believe that only Japan will supply funds. edited

* Role in World Economy Precludes Isolationism

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[Interview with Hiroshi Kurosawa, Industrial Bank of Japan vice president, by SEKAI chief editor, Akio Yamaguchi: "Japanese Money and Japan's Role: In Order for Japan Not To Be Isolated"; date and place not given]

[Text] **It Will Not Be Solved by Structural Talks Alone**

[Yamaguchi] The international expansion of the Japanese economy in recent years has been conspicuous, and in particular the buying up of overseas companies and land by Japanese money is producing an intensification of economic friction with Europe and America. Negotiations between Japan and America have progressed from individual items to structural consultations, and the second Structural Impediment Initiative [SII] talks ended on 7 November 1989. It is reported that the U.S. side expressed dissatisfaction, saying "the response of the Japanese side was not flexible." Having seen the results of the recent U.S.-Japan SII talks, how do you feel about them?

Kurosawa: The other day NIHON KEIZAI SHIMBUN polled the readers of the "Monday NIKKEI" column concerning the U.S.-Japan SII talks. The result was that 45 percent responded that it is "reasonable," 15 percent that it is "outrageous," and 40 percent that one "cannot say either way," so for the most part it was "cannot say either way" or "reasonable." I, too, feel the same way about the content of the talks. Land is expensive in Japan, but there also exist things like successful bids of one yen, and it is fine to correct such things. But the problem lies in the fact that some people in America are beginning to think that everything will be solved if that is done.

First of all, by the exchange adjustment of the Plaza Accord of September 1985 $1 changed from Y240 to Y120. That turned out to be totally ineffective, so macroeconomic adjustment was carried out, and the economy was made into one led by domestic demand. Even that was no help. Therefore, next it became MOSS

[market oriented sector selective] (by individual field) conferences, beef and oranges became issues, and what emerged at the end was Super 301. But these were all ineffective. Therefore the feeling has emerged that structural consultations will be the ultimate panacea. Moreover, it is arranged that there will be a blueprint in March, and a final report at the end of August. But even if we do what is asked of us, it will not be much help in improving the balance of trade. I think that at least it will be no help at all by August 1990.

This appeared in THE WALL STREET JOURNAL of 8 November: what would happen if in ordinary everyday life neighbors said to each other "the shape of the branches on your tree is no good; it bothers me, so cut it down for me." "What is wrong with your child's education? Shouldn't you correct it in this way?" This could be very unpleasant; and America and Japan are doing just such unpleasant things.

[Yamaguchi] You are saying that newspapers write "consultations on structural problems" but that it is really "consultations on structural impediments."

Kurosawa: That is true. It is the Structural Impediment Initiative; to be accurate it is consultations on structural impediments, but when it was translated into Japanese, structural problems ended up being secretly substituted for it.

[Yamaguchi] What is the outcome of the difference in meaning in such a case?

Kurosawa: It is like calling "defeat in war" the "end of the war"; there really are impediments; and these talks are consultations which tell Japan to remove the impediments.

[Yamaguchi] So it is not just a matter of doing things well through discussion, right?

Kurosawa: It is a matter of removing this many impediments, making an interim report on it by March, and publishing it by August. But probably about the only thing that is possible now is a law on large retail stores. The law on large retail stores will probably come out in March, will it not?

[Yamaguchi] Because from the beginning it had also progressed in that manner domestically, right?

Kurosawa: Right. We have waited all of 10 years for a law on supermarkets, and this is a haphazard way to proceed.

[Yamaguchi] Beside that, such things as strengthening the Antimonopoly Act have also come up. Would you comment on that?

Kurosawa: Even if you say you will strengthen the Antimonopoly Act, revising laws, and so on, cannot be done easily. After that, even if we are told that it is a "main bank" or an enterprise grouping, etc., nothing can be done about it.

[Yamaguchi] An article appeared in the ASAHI SHIMBUN of 10 November which said the paper had obtained a U.S. Government document which pressed for improvement of financial groupings. The document said that it was a question of opening company information to the public and of strengthening regulations on company holding of each other's stock. How about that?

Kurosawa: Even if you say you will improve such things, it is difficult, and is it necessary in the first place?

The other day Assistant Treasury Secretary Dallara was visiting Japan in regard to the question of increasing the capital of the Third World Bank; he is the real originator of the plan for structural consultations. That idea is found in the Committee on the Yen and the Dollar.

[Yamaguchi] That was 1984, right?

Kurosawa: It was actually the idea of setting an agenda. Moreover, around that time a big fuss was being made about beef and oranges and the MOSS talks and so on, so it had the effect of diverting attention from that.

Now they are doing the same thing all over again. The Committee on the Yen and the Dollar can do things if it has the cooperation of the U.S. Treasury Department and Japan's Ministry of Finance. But it is impossible to do the same thing in a form which drags in everything from land, distribution, price setting, the Antimonopoly Act and the Ministry of Construction. So I told Dallara that if America chafes unreasonably on this kind of utterly impossible thing, a strong reaction against it will emerge among the Japanese people.

Moreover, it is because they say the fault lies in Japanese customary practices. They say "main banks are outrageous." When they say that, it ends up with our side saying "What do you mean! Your country is to be pitied because it has no main banks. That is why companies go bankrupt easily."

[Yamaguchi] Giving tit for tat, right.

Kurosawa: Right. Therefore, I told Dallara "Even if you intend to change our customary practices, there will emerge only a reaction against you, so you will gain nothing. I will give you some good advice. Try checking the certifications of all sorts of government offices, because there are well over 10,000. Try checking up on them, one by one, and telling people to abandon those which are questionable. If you do that the Japanese people will all applaud you." After all, there are lots of anachronistic certifications.

[Yamaguchi] Previously our magazine also had the pleasure of interviewing Chairman Ito of Kanebo, Ltd. and Chairman Nakauchi of Daiei, Inc., and they both said the same thing.

Kurosawa: Furthermore, Dallara said that it is difficult for new companies to enter a field because of the existence of enterprise groupings, so I said "Take a look at Japan's supermarkets, for example. The top one is

Daiei, and the second is Ito-Yokado Co., Ltd., and they do not belong to any zaibatsu. They are neither Sumitomo nor Mitsubishi. They both started from small stores and built up the businesses by themselves. So this is probably a major example of entering a field, not as a matter of enterprise groupings, but of how much one must want to do it, and how hard one must strive in order to be able to enter."

He said that land is so high that Chrysler cannot push its own cars, nor can it set up a dealer system. Moreover, he said that in America Japanese cars are also displayed at places which are selling GM cars, but in Japan, whether it be Nissan or Toyota, they will not handle U.S. cars. I said, "But take a look at BMW. BMW is not being helped by Honda, nor is it being helped by Nissan or Toyota. In spite of land being expensive, it began a dealer system by itself five years ago, and has gone from zero to selling all of as many as 20,000 and 30,000 cars." When I said that, his mood gradually darkened.

[Yamaguchi] But it would be awful, would it not, if America were to think that this time it held the trump card.

Kurosawa: U.S. Trade Representative Hills is not saying that. She says that macroeconomies are responsible for this U.S.-Japan imbalance; therefore, she understands that the U.S. macroeconomy is also responsible, but she says the Japanese macroeconomy is also responsible, and cites such things as land and distribution. I do not know whether land and distribution are a part of macroeconomics, but that is what Hills says.

However, the imbalance has still not been corrected. The deficit with Japan is now 50 percent of the entire U.S. deficit. In August it fell to about 37 percent, but in July it was 49 percent. When one takes an average of January through August, as might be expected, it is close to 50 percent, so the amount declines steadily, but the ratio rises. Therefore, in order to divert attention from the debate on what has happened, they do so by saying, "wait a bit, we are now trying to change Japan's structure." In spite of this, the deficit does not improve, so now it has again become a matter of people asking what has happened.

[Yamaguchi] It means that nothing at all has changed, right.

Kurosawa: Exactly. In other words, structural impediments cannot be eliminated completely. Therefore, in spite of the fact that in the beginning they began by saying that it had to be the macroeconomy as a way of diverting attention, somehow they built their hopes up around this idea, so now they wonder what happened.

The IMF forecast holds that in 1990 both the Japanese trade balance and the U.S. trade balance will deteriorate. What it means by "deteriorate" is that the Japanese surplus will grow and the U.S. deficit will grow, and that is the IMF forecast that came out in September 1989. According to this, the U.S. current-account deficit will be $125.1 billion in 1989 and $138.7 billion in 1990, a worsening by all of $13.0 billion. The Japanese surplus will be $72.0 billion in 1889, and $89.7 billion in 1990, worse by all of $17.0 billion. However, the Japanese trade surplus was $95.0 billion in 1988, and is expected to improve greatly in 1989, to be about $80.0 to $82.0 billion. Therefore, I have doubts concerning the IMF's forecast.

There are some who say that the fact that it appears as though Japan's trade surplus has settled down is a temporary phenomenon due to the low yen, and so on, actually, imports are growing and exports have ceased to grow. With this, the direction of a trend toward decreasing trade surpluses has been set to some extent. America is gradually beginning to feel the onset of a recession. Such being the case, this IMF forecast is off, and in 1990 the situation in both America and Japan should improve a bit more. I hope that it will be possible to discuss both the blueprint of March and the conclusion of August in that kind of favorable atmosphere, and I feel that there is a greater than 50 percent possibility of that happening.

And when it comes to discussing U.S.-Japanese relations, when I listen to what LDP Diet members such as Shintaro Ishihara are saying, in many cases the arguments have become extreme. The kind of statement which incites that kind of anti-American sentiment is not good. Many people say that what the U.S. side is saying is reasonable, so no good will come of stirring up anti-American sentiment for nothing.

I happened to be in Paris at the beginning of September 1989, and was invited by an American to attend a breakfast where Carla Hills was to give a speech, so I went along with him nonchalantly to a restaurant off the Boulevard de Champs Elysees. And Carla Hills furiously denounced the closed nature of the French and EC markets. For example, she said, "You said that a Nissan car built in England is a Japanese car, right? That is preposterous. All of 80 percent of its parts are supposed to be British. Stop doing that." It was not a chance remark at that occasion; it was in her original copy. In other words, this is her job, so she does it wherever she goes. She doesn't bash only Japan.

There Is Too Much Money, so There Is no Place for It To Go.

[Yamaguchi] I would like to move on to the topic of Japanese money; would you please tell us a bit about why it has become this much of a problem, and what started it off?

Kurosawa: At present, nine of the world's 10 largest banks are Japanese banks. Next, the huge Taiyo Kobe Mitsui Bank will also appear. There are various ways of compiling statistics, but some people hold the view that the 10 largest banks will all be Japanese banks.

And if you look at the world's 50 biggest banks, America, Germany, England and France each have only five or six.

but Japan has 24. That is one-half. I am absolutely amazed at what has happened, but the primary cause is the strong yen. Assets suddenly double when converted into dollars.

[Yamaguchi] Can we take it that this happened after the exchange adjustment of the Plaza Accord?

Kurosawa: Yes. Before the Plaza Accord there were no more than about one or two Japanese banks among the top 10.

To give a bit more detail, roughly three-fourths of the total assets of Japanese banks are yen assets, and one-fourth is foreign currency assets. Therefore, three-quarters of their assets doubled. And, unlike U.S. and European banks, Japanese banks have money on deposit from those to whom they make loans. That is, lending 80 and having zero on deposit is the procedure of U.S. and European banks, but with Japanese banks it is arranged to lend 100 and have a deposit of 10 or 20, so their assets are inflated by about 20 percent.

Therefore, the regulations of the BIS (Bank for International Settlements) were given, and it became necessary for banks to retain eight percent of one's own capital, so this is having some effect. For example, in the management of international syndicate loans, in actual results for 1988, of Japanese banks Sumitomo was in seventh place, Fuji 14th and The Industrial Bank of Japan was, third out of 20. After the BIS regulations came into effect it ceased to be possible for Japanese banks to act too wildly in the world of syndicate loans. Up until a few years ago the one in the top spot was the Bank of Tokyo, the second was The Industrial Bank of Japan, and four or five out of the 10 were Japanese banks. Therefore, some amount of effect is manifest there.

Moreover, if one tries to observe the eight-percent rule, after this the growth of profit or one's own capital and the growth of assets must agree. But at present, the growth of assets is roughly about 15 percent, so if they go on doing this, the profit would also have to grow by 15 percent.

[Yamaguchi] That is awful.

Kurosawa: Therefore, it will have to gradually slow down. At present they are increasing capital steadily, but if they increase capital excessively there will be pressure on the stock market, so they cannot do all that much. I imagine they will begin to slow down gradually.

When people talk about Japanese money other than banks, it is a so-called portfolio (such so-called paper as stocks and bonds) investment; for example, net acquisition of stock in FY88 was $3.455 billion, and that of bonds was $86.645 billion, combined for an increase of $90.1 billion. For 1989 we only have the figures from January to July, but if we calculate it roughly by an annual rate, this, too, comes to about $90.0 billion. FY86 was $109.7 billion, FY87 was $74.6 billion, FY88 was $90.1 billion and FY89 comes out again to be about $90.0 billion, and that is the amount of foreign securities we are buying. In other words, the balance is increasing.

Beside that, if we look at, for example, acquisition and disposal of bonds, in FY88 acquisitions were $1.3737 trillion and disposal was $1.2870 trillion. Anyhow, about $2.6 trillion of business was conducted in the buying and selling of bonds. Therefore, it is natural that it would exert a terrible impact if it once began to run wild. Moreover, most of the Japanese investment is the purchasing of U.S. Government bonds.

[Yamaguchi] About how much is the ratio for America?

Kurosawa: It is probably about one-half. People from such places as Canada, Australia, and Germany often come and ask us to buy some of their bonds too, but we ask them if it would really be all right to buy them. What I mean, is that if one operated by units of about $10 billion or $100 billion, the markets in Toronto, Sydney and Frankfurt would end up collapsing. In that sense, the money can only go to America. That is, the amount of money is so huge, that most of it has to go to America. As to why a huge amount of money comes out, the prime cause is that there is a surplus of money because of the trade surplus and the fact that there are few investment opportunities in Japan.

[Yamaguchi] Has Japan taken advantage of the so-called speculation boom in America over the last few years?

Kurosawa: There is not too much of that aspect in investment in securities. Rather, with stocks, etc., there is a sense of crisis because of "Black Monday," so people probably do not speculate too much. People buy American securities solely because there is too much money in Japan and no place to invest it. If they invest in Japanese Government bonds, the return is 5 percent, but if they invest in U.S. Government bonds, it is 9 percent, so it is all of 4 percent higher. If this ceased to be the case, people would immediately stop doing it.

People often say that since Japanese money has power, Japan should give up a bit on investing in U.S. Government securities in order to make trouble for America, but this argument is completely wrong. Why is the money going there? In a word, it goes because it is profitable. Since it goes because there is a difference between five and nine percent, and America is four percent higher, if it became five and six percent, no one would invest in America. Moreover, if Japan became five percent and America four, the money would all come back to Japan. It is not something that can be stopped by a political policy.

[Yamaguchi] About how much volume is moving every day?

Kurosawa: If we look at the amount of exchange settlement, London is $187.0 billion in one day, New York is $128.9 billion and Tokyo is $115.2 billion. This is the one in which dollars are bought and yen sold. When all of it is combined, it is roughly $400.0 billion. Multiply

400.0 by 250 days. That is, if you multiply it by the 250 which is left after subtracting Saturdays and Sundays from the 365 days of a year, it comes to roughly $100 trillion. Even if we include OECD [Organization for Economic Cooperation and Development] trade both ways, foreign trade is $4 trillion. World trade is between $2 trillion and $3 trillion one way. This means that amounts tens of times the trade settlement are being dealt in the world's banks every day, so if this money begins to move, no one has any way to stop it. There is no way to stop it other than to manipulate interest rates drastically or to revive exchange controls.

[Yamaguchi] If a money-monster began to move about on its own in that manner, a situation might occur which could not be controlled by political policy?

Kurosawa: The possibility does exist. Therefore, we constantly hold G-7's (conferences of the finance ministers of seven advanced countries) so that kind of senseless thing will not occur. The G-7, etc., are always assembling and discussing things, and are telephoning every day, so in that sense I think it is functioning, even if not in a fully satisfactory manner.

Forty Percent Is Japanese Money

[Yamaguchi] You have been talking about there being such a surplus of Japanese money that avenues for its investment have begun to disappear. Recently the transferring of it to fixed assets as in M&A (mergers and acquisitions) has become a problem. Would you comment on that?

Kurosawa: Even within M&A, the most extreme is the LBO (leveraged buy out—a method whereby the side making the purchase first sets up a paper company to be a receptacle, and this new company raises the money to make the purchase by borrowing money from banks, with the assets of the takeover-target company, and so on, as collateral, and by issuing so-called "junk bonds," which are high-return corporate bonds). U.S. banks furnished $45 billion of the LBO financing in America, and Japanese banks provided $20 billion, about one-half as much as the U.S. banks. At present, it has become common knowledge that Japanese banks are participating by about 30 to 40 percent in LBO's in other countries. Therefore, LBO's are impossible if Japanese banks do not participate. A typical example is the recent case of United Airlines. It is said that it was impossible when Japanese banks said they would not participate, and that because of that, the stock market fell on 13 October.

[Yamaguchi] In short, it is impossible to raise funds if Japanese money does not participate, right?

Kurosawa: That is true of things like LBO's. However, an LBO is a rather extreme case. That is, to put it simply, an LBO is something in which one buys up all of a corporation's stock at a high price by means of money borrowed from a bank, and in regard to the excess amount borrowed from the bank, one reduces the debt by dividing up the subsidiary and selling it off. It resembles a kind of vivisection, and in one sense, it is a self-negation of capitalism. Since it means buying up the shares held by all stockholders, a large amount is required in loans. Therefore, when there is no financial institution which supplies capital in large volume, an LBO will not be realized. Such being the case, 24 of the world's 50 largest banks are Japanese, so it is a matter of course that it is impossible unless Japan participates.

And another thing, this is a BIS statistic, but if we make the total of foreign assets of the banks throughout the world which are carrying on the international businesses of lending money, holding deposits and buying negotiable securities outside their own country 100, Japan is 38.2 and America is 14.7. In other words, when it comes to lending money overseas, at present roughly 40 percent is done by Japanese banks.

[Yamaguchi] It means that when something happens 40 percent of the money used is Japanese money, right?

Kurosawa: That is correct.

[Yamaguchi] Do you suppose one can go ahead and say that nothing can be done about anything, including even things like LBO's, because it is going in accordance with economic laws?

Kurosawa: If we are to discuss LBO's, in a word, LBO's become riddled with debt; if it is all borrowed money, it becomes impossible to pay the interest, and it collapses, so generally the way of doing it up to now is for 10 percent of the money used to buy back the shareholders' stock to be furnished by the person who wants to carry out the LBO. And about 20 percent is junk bonds (corporate stock issued at a high rate of return), and 70 percent is bank loans. But at present the junk bond market has become a bit difficult, so LBO's may be difficult to conclude until it recovers.

[Yamaguchi] Would it be difficult even if Japanese banks tried to do it?

Kurosawa: Japanese banks never plan LBO's by themselves. Because it is a matter of them being asked to participate in one that an American firm has planned.

The Use of Money Is Being Called Into Question

[Yamaguchi] At a time when Japan's surplus of funds has become a problem, how are things on the side of the Japanese Government's policy response?

Kurosawa: If one says that too much money is going out, the natural response is: "In that case, what is wrong with using it in Japan?" Japan now has growth of 5 percent; if this became growth of 10 percent, for example, one could probably do things like building bridges and unnecessary tunnels in Japan, but that would not do. Such being the case, there is no longer any choice but to invest outside Japan.

It probably would not do to keep money in the dresser in one's home. It is said that large life insurance companies have to do something or other with Y10 billion of surplus funds every day, so money collects in a manner which staggers the imagination.

[Yamaguchi] In that case, I suppose the problem becomes how to use it.

Kurosawa: You are right. But right now, it has become a situation in which public investment cannot increase at all. There should be searching for other investment possibilities.

[Yamaguchi] But the construction industry is in very good shape.

Kurosawa: If we invest more there will be no one to do the work, and the economy will overheat. But, how many bridges are there over the Tama River, for instance? There are probably about 10, right? Moreover, most of them are one lane each way. Why can't they increase the number of lanes? We could do with a bit more of public works in a place like this. But the Ministry of Finance says that current public investment is fixed at this much for transport, this much for construction and this much for something or other, so it cannot be distributed according to priority. Therefore, that is a place where politics must display leadership and act resolutely.

[Yamaguchi] In the end, it amounts to only large-scale projects being possible, right. Therefore, it becomes something like a new bullet-train line, which doesn't make much sense.

Kurosawa: It seems to me they could do a bit more of the kind of thing that uses money in Japan.

[Yamaguchi] At the same time, there is also a problem regarding how money is used overseas, is there not?

Kurosawa: There is. So-called investment in fixed assets reached $47.0 billion in 1988. It was $33.0 billion in 1987, $22.3 billion the year before that, and $12.0 billion the year before that. Therefore, it became $10.0 billion, $20.0 billion, $30.0 billion and $40.0 billion, so 1989 will be $60.0 billion. This means that Japan is the world leader in this kind of overseas investment.

And the breakdown of the $47.0 billion of 1988 is 29.4 percent for manufacturing industries and 69.4 percent for non-manufacturing industries. That is, investment in the building of factories was 30 percent, and other investment was 70 percent; among these, the most numerous were investments in finance and insurance, but the one that is growing is real estate; it is 18 percent, and has gradually increased.

[Yamaguchi] It has increased rapidly from 1986 onward, has it not. Is this, as one might expect, because of the strong yen?

Kurosawa: Yes. There is the strong yen and the high price of land in Japan. Speaking figuratively, if one sold the Japanese islands in their entirety it would amount to enough to buy America four times over. If one sold one-fourth of Japan one could buy all of America, so if one owns 395.4 square yards of land in Tokyo's Kayaba-Cho, one can buy a building in Manhattan. When Japanese go to America, something like a golf course is dirt cheap, so they rush to buy them. Even if we are told to correct this, it is very difficult unless it is changed from the foundation up.

[Yamaguchi] Still, it has become a target of American criticism.

Kurosawa: Rather than criticism, there is a feeling of being hated.

And, furthermore, stocks are high in Japan. The aggregate market value of stocks is the amount of money arrived at by multiplying the world market prices by the number of shares; if one makes the combined total to be 100, Japan is 43 percent when one combines Tokyo, Osaka and so on. America is 29.5 percent, even if one combines Chicago and New York, and England is 8.7 percent. Forty three percent of the aggregate market value of the world's stock is Japanese stock.

The Ills of American Capitalism

[Yamaguchi] I think the flow of money in that form is worsening the evaluation of Japan in Europe and America, and causing Japan bashing to escalate. What is your view?

Kurosawa: To discuss concrete examples, there is Sony's purchase of Columbia and Mitsubishi Estate Co., Ltd.'s purchase of Rockefeller Center. First of all, take Sony's purchase of Columbia, NEWSWEEK made this a cover story, and depicted symbolically the Statue of Liberty having become a geisha. But that was a matter of the magazine NEWSWEEK having reacted a bit emotionally; there are all sorts of opinions in America too. Former Defense Secretary Weinberger visited Japan in the midst of the uproar and said that Columbia would probably have gone bankrupt if Sony had not bought it, that it was able to escape bankruptcy because Sony bought it.

If Japan were to buy TIME magazine, for example, it might be attacked. Therefore it is necessary to be a bit careful about buying media. Motion pictures may be a borderline case, but over one-half of U.S. motion picture companies are held by foreign countries. They are selling all of them, so I imagine one need not become too nervous in regard to motion pictures.

Next there is Rockefeller Center, but Rockefeller Center was on the market for about four months. They went around taking it to Mitsubishi Estate Co., Ltd. and Mitsui Real Estate Development Co., Ltd. and some construction company or other, inviting them to buy it. Among them Mitsubishi Estate was the one that offered the best deal, so they sold it to Mitsubishi.

And Rockefeller, too, came to Tokyo a few days earlier, and said: "I have had dealings with Mitsubishi for some time. I am glad that it was bought by a friend. Moreover, Mitsubishi was kind enough to ask me to continue to serve as chairman. I am very happy. Who would criticize it?"

Well then, looking at how much Japan holds of the balance of U.S. real estate, it is probably on the borderline of one percent. There is an aspect of waiting, insofar as possible, for the dust to settle. And it is necessary to not do the kind of thing which would be too unreasonable and stand out. For example, Bloomingdale's and Saks Fifth Avenue, two big New York department stores are now on the market. It is said that a certain department store will buy one of them. This may be true, and cannot be helped. Both Bloomingdale's and Saks are the result of an LBO that went too far. It has become necessary for the purchaser to sell off his own assets.

[Yamaguchi] It means the buyer put his own neck in the noose, right?

Kurosawa: Right. Therefore, it may be possible to call this a manifestation of the ills of American capitalism.

Arrogant Japan

[Yamaguchi] I think such things are probably understood in America, too. Then why is Japan thought of as a country that people do not understand, or that the Japanese are aliens?

Kurosawa: I imagine that, looking at it as an American, all sorts of thoughts come out, all mixed together: that America was originally a big brother and helped Japan and is taking care of Japan's defense, also that Japan was originally the detestable blighter who started the war. Japan must pay attention to that.

[Yamaguchi] Did you, yourself, also experience that feeling?

Kurosawa: They do not come out and say it. There do exist people who feel something like, for example, "they should have dropped three atomic bombs instead of two," but they do not come out and say it. However, it is certain that there is an aspect in which the Japanese must take care in investing in America or Europe. They do not come out and say it, but somewhere inside their hearts they are thinking it.

If an America says anything to a Japanese about Pearl Harbor, the Japanese says "What do you mean? You dropped the atomic bombs, didn't you? That makes us even, doesn't it?" The other side does not look at this as being even.

It was 50 years ago that only the Japanese were rounded up and placed in concentration camps. At that time they put neither people of German ancestry nor people of Italian ancestry in the camps. As to whether people's feelings change after 50 years, it is not that simple a thing. However, now America has said it was wrong, and is paying compensation. That is very much the broad-minded, fair aspect of Americans' thinking, but conversely, Japanese never say they were wrong. People ask whether the Japanese have even once said that Pearl Harbor was wrong.

[Yamaguchi] After all, Japan does not say it even to the Asian countries that it invaded.

Kurosawa: It does not say "we were wrong," it says "we caused you trouble."

What is different from the Germans is that the Germans say, "We are the ones who started the last war; we must be fully aware of this sin," and Brandt goes to Auschwitz and bows his head and lays a wreath. I do not know what he is thinking in his heart, and it is also convenient because he is foisting it all off on Hitler, but he is apologizing frankly.

In Japan, it is all connected together, so Japan does not apologize, and it asks "What is wrong with selling good things cheaply and everyone buying them?" If Japan thinks it can make its way in the world this way, it is greatly mistaken.

[Yamaguchi] Recently there has even emerged, has there not, the argument that Southeast Asian countries were able to become independent thanks to Japan having gone there.

Kurosawa: This is outrageous. Because if you go to Singapore there is a monument to commemorate the killing of tens of thousands of overseas Chinese by the Japanese Army, and it is said that when watching movies of World War II there are some people who clap their hands when the atomic bombs fall.

[Yamaguchi] Even now?

Kurosawa: Yes. They say "good." They probably mean that it saved them by crushing that strange country, Japan. Even in investing in Southeast Asia, it is no good if one fails to consider that reality, and orders people about in an arrogant manner. The Japanese are somewhat lacking in awareness on that point.

[Yamaguchi] I think that the more important a country becomes the more natural it is for such a problem to cause severe friction.

Kurosawa: That is true. Anything would do when we were small, but, for the past four or five years, we have continually had a surplus of $100 billion. Lately it has begun to decline, but ordinary people think it has not declined in the least. And we are rapidly buying foreign land and buildings with it.

But even Japan must use its money in foreign countries if it cannot use it at home, so it is necessary to do it skillfully by direct investment or some other means.

Therefore, rather than buying real estate, it is better to build factories insofar as possible. If Japan builds factories, and it reaches the point where, for example, 2 million of the 2.3 million automobiles that Japan is exporting to America are made in America, we will arange to export only 500,000 or a million beyond that. And if we do it in a manner in which 10 percent or 20 percent of the cars that we make in America return to Japan, our trade surplus will go on shrinking. If we build factories in America by direct investment and manufacture things over there, we can get by without transporting things from here, and if they return from over there it will become imports, and contribute to U.S. exports.

At present everyone is investing in Southeast Asia with the calculation that roughly about one-half will return to Japan. Roughly one-half of the cameras, calculators and audio equipment currently being used in Japan are manufactured in Southeast Asia. Therefore, I think that 10 years from now these items will probably no longer be made in Japan. Japan's role is to do it that way, to improve Asia's balance of trade, nurture Asian export industries, and go on doing it so that there will be coexistence and mutual prosperity. But at that time it will not do to talk to the people of Southeast Asia in a manner such as "Hey, stop that, get out of the way! I'm going to build a factory." It must be "Please allow me to build it."

[Yamaguchi] Speaking of relations with Asia, now, for example, wages have risen rapidly in the Republic of Korea, have they not. Japanese companies have begun to pull out in succession because costs have risen. What should we think of this problem?

Kurosawa: When wages double in the space of three years, it is to be expected that companies that had gone there because labor costs were low would give up, so it cannot be stopped. In the case of the Republic of Korea, there is the further factor of a strong won, is there not? It is a one-two punch. And on top of that, there are strikes. The Republic of Korea's industries, too, are already begining to invest in Bangkok, and so on, so Japan is not the only one that is running away from the Republic of Korea.

Therefore, this is a matter of pulling out in rapid succession and saying, "We will return this to fields and mountains, you are all fired." This is unwise. This is not the way to do it; you have been the recipient of another country allowing you to rent their place, so when pulling out, too, there is etiquette, and one must follow it.

The Japanese have a trait of looking down a bit on Asians, and there was an instance in which, once in Thailand, a Japanese was tried in court for kicking the back of a female worker who was squatting down. After all, the Japanese must behave as befits rich people and leaders, but, regrettably, they do not. This has not been a part of Japanese education.

A Fearsome Closed Society

[Yamaguchi] As you, yourself, say, the reality is that however much money Japan has, it cannot live without America or the EC. Therefore, I think that in order to go on coexisting, the manner in which Japan, which has money, behaves will be called into question in the future.

Kurosawa: It is often said that even when building a factory in America one should do it as a good corporate citizen. In other words, if it is a factory in Kentucky, one must do as the Romans do and perform the work in a manner befitting a Kentuckian. Start out by going to church on Sunday. Young people nowadays are lacking in the mental attitude that when going to a foreign country one must study that country.

And I think that the biggest cause of the Japanese not knowing how to behave when they go to a foreign country is the fact that there are no foreigners in Japan. Before World War II there were many foreigners in Japan. Lately people from all sorts of countries have entered Japan, but that is called illegal, and even in such things as readers' letters to newspapers people say such things as "Do not allow foreign workers in easily. Consider it well, what would you do if a foreigner lived next door?" In other words, after the war Japan has become a fearsome closed society.

After the war the Japanese pursued the single path of economic growth, and said "catch up with advanced countries, come what may" so they are forgetting a considerable amount of other important things. It has become a style in which, if one is able to board a Chuo Line train at Shinjuku Station during the rush hour, one then spreads one's elbows as widely as possible so as to prevent, as far as possible, others from boarding, and says "Ah, good" when the door closes. Even if people collapse in the street, it has become common for people to pass quickly by, pretending not to notice.

This, too, may be getting off the main topic, but take, for example, volunteer activities. People say that Americans do it because they have leisure, but the Japanese fail to understand the concept. According to a 1988 Gallup Poll, when 2,000 people 18 years or older were polled in America 45.3 percent were engaged in volunteer activities. They were allotting 4.42 hours to it in one week.

If one asks what the situation is with Japan, for the most part probably all anybody does is contribute Y100 to the Community Chest once each year. The Japanese are very lacking in the spirit of wanting to help those who are poor, in trouble, or alone. It has become an ideology of everything is fine as long as one's self is all right.

[Yamaguchi] Moreover, if one does not do that, one will end up being left out of this corporate society, right?

Kurosawa: In America people are not recognized as well-rounded human beings if they do not engage in volunteer work. It has become a social status symbol to

say that one is doing it. But it is not just people in high positions who are doing it. Poor people also do volunteer work.

And what really surprises me when I go to foreign countries, and it is true also of Brazil, and so on, is that adopted children are extremely numerous. People have four children of their own, and in addition they adopt a black child or a Vietnamese. When I asked "what is the arrangement for inheritance of your estate?" they said "If we made a distinction in such things we could not handle it as our child." In other words, the adopted child is equal to the other four children. That is inconceivable in Japan.

[Yamaguchi] The difference between America and Japan is obvious when one looks at the way of handling Vietnamese refugees, is it not?

Kurosawa: It is. The censure for having done things with the attitude that money is everything in human affairs has come home to roost.

[Yamaguchi] I suppose the Japanese have forgotten how to go on living in the international community.

Kurosawa: We have. Bankers may believe that all human activity revolves around money but this seems a bit like self-negation, and looking at it in perspective, this problem is not something one can laugh at. When Japan was little other countries thought, "It is a bit of an oddball, so make allowances for it." But when it became the biggest creditor nation in the world, and rose high in per capita GNP, and ODA [overseas development aid], bcoming the highest in the world, and when Japanese banks began to participate in 40 percent of any deal that are made, as might be expected, it was only natural that Japan would be bashed if its actions and behavior are not those befitting a leader.

I often say that just being rich is a cause of being hated by people. That is, the more that cigarette butts pile up in ash trays, the dirtier they get, and the more money that rich people accumulate, the greedier they get. You may think that you are liked, but they are all toadies who come around thinking to receive a share of your money, so if you become rich, your friends will disappear if you are not careful. Therefore, in order to steadily acquire friends even when one is rich, one needs training in consciously considering things from the standpoint of the other person.

[Yamaguchi] Thank you very much for giving so much of your time.

• Possibility of Downturn in Economy Seen

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[27 Feb 90 p 1]

[Article by SANKEI economic section reporter Masao Shin]

[Text] **Broken Myth; Weak Yen and High Crude Oil Prices Influence Commodity Prices**

It's Monday again. The Tokyo Stock Market displayed the second biggest slump in its history, and the average stock price fell to the 33,000-yen level. The yen rate on the Tokyo Foreign Exchange Market also weakened, going as low as 149 yen per $1 at one point. A factor in the selling is the heightening anxiety about inflation because of the rise in interest rates. High stock prices in the past five years have built up personal spending, added vigor to business activities, and brought an unprecedented boom. However, the crude oil price has already risen to the level of $20 per barrel. It's turned out that the "three lows" (namely low interest rates, the strong yen, and cheap crude oil prices) of the past five years are collapsing all together. The Japanese economy has made a complete change, and has started to show signs of uneasiness.

In discussing the backdrop for the steep fall in stock prices, Mr. Yoshio Suzuki, the vice director of the Nomura Research Institute, points out that "The origin of the anticipated rise in interest rates lies in Germany." Germany, where the movement for East-West unification is growing. If East Germany and West Germany—whose economies differ qualitatively—are united, the finances of West Germany will suffer, in effect being dragged down by East Germany. Also, because large quantities of goods will be needed for East Germany, demand will increase, and inflationary pressures will be strengthened. Under such circumstances, West Germany, which is sensitive to inflation to begin with, will be forced into raising interest rates. An increase in interest rates in Germany will cause the same in Japan. Internationally high interest rates will promote a funds flight from unstable stock markets to stable financial markets, and this is how the fall in stock prices occurs.

However, that is not the only factor behind the slump. Mr. Norinobu Takahashi, senior researcher at the Mitsubishi Research Institute, Inc. offers the analysis that the "Japanese economy has become structually unstable."

The Japanese economy has glorified the "three lows"—to be precise,it should be the "expensive trio" (the strong yen, high stock prices, and high land prices) plus the "cheap duo" (low interest rates and cheap crude oil). Such almost extraordinary increases in land prices and stock prices have bloated asset values, and have increased plant and equipment investment and personal spending. The strong yen and cheap crude oil have kept import prices down, and restrained inflation anxiety. However, the "expensive trio" and the "cheap duo" now have made a 180 degree turn, and have become factors acting as a drag upon business.

In particular, the recent weak yen and expensive crude oil have caused a change in general prices which had been stable since 1985.

Although the general wholesale price index in January rose a mere 0.1 percent over the same month last year, there are rising tendencies in prices of petroleum products, machine tools, lumber, and construction workers' wages. The rise in prices of petroleum products was caused by last year's weak yen and high crude oil prices. The rise in prices of machine tools and labor wages are because of the increase in equipment investment, and the manpower shortage. None of these were evident during the days of the "expensive trio" and the "cheap duo."

The future of the money supply, a leading indicator of inflation, is also a matter for concern. A prompt report [on the money supply] for January showed that—for the first time in 15 months—the money supply recorded an 11 percent growth rate compared to the same month last year, thus sending up a warning signal. Labor unions are scheming for rather high wage increases in the spring labor offensive. The circumstances with regard to prices are only deteriorating.

Changes can be seen in overseas relations also. While direct foreign investment is increasing dramatically, the trade surplus has decreased sharply, marking a 90 percent decrease in January as compared to the same month last year. Japan's official gold and foreign currency reserves, which are a symbol of her [status as an] economic superpower, dropped below the whopping $100 billion mark last year. Thus, there has arisen the possibility that within this year Japan may fall to the position of second in the world, being surpassed by West Germany. As for the exchange rate level, the reference market range of $1 =125-145 yen as of the Christmas agreement of the G-7 (December 1987), is now out of date. European and American dealers say that "the true capability of the dollar is in the neighborhood of 170 yen."

"The positions of the Bank of Japan and the Ministry of Finance, in response to this sudden change in situation, are delicate. The immediate issue for their examination is the manupilation of the fourth official discount rate. In order to wipe away inflation anxiety, they would like to raise interest rates. However, once they launch into raising interest rates, business activity will be cooled and stock prices will drop.

On the other hand, although the slowdown of the U.S. economy is evident, the United States cannot plunge headlong into monetary relaxation, because inflationary pressure is as strong as ever. Under such circumstances, if Japan were to raise interest rates, the flow of funds from Japan to the United States might even stop. Yet, if the United States were to raise interest rates, stock prices would drop sharply, and it might even lead to the most-dreaded scenario, a "dollar slump."

The Japanese Government and the Bank of Japan are suffering from immobility in a dead-end street. "The Japanese economy is showing its true colors,"—all of a sudden, such comments can be heard among those involved in finance matters.

[28 Feb 90 p 8]

[Article by SANKEI economic section reporter Hiroshi Sasaki]

[Text] A Shadow Over Financial Strategy—Low Cost Funds Supply Becomes Difficult

The stock market is said to be an Aladdin's lamp to businesses. This is because, with its high stock prices, it enables them to greatly increase their capital and raise low-cost funds. This Aladdin's lamp is about lose its magic.

"Financial income and expenditures during the previous period show excess disbursements of 5.4 billion yen. We intend to shrink that down to 3 billion yen. Therefore, we can expect a contunued improvement," Mr. Daikana Miyoshi, the managing director of Showa Denko K.K. said in a tone filled with confidence.

Since February of last year, Showa Denko K.K. has accommodated 146 billion yen from the capital market through a capital increase of market value issues and loan floatations such as convertible bonds. Out of 146 billion yen, 50 billion yen worth of convertible bonds had a 1.9 percent interest rate. The prime rate (the most favored loan interestrate) was 5.7 percent. Therefore, the cost was so low that there would be a margin even if the raised funds were just put into a bank in a time deposit.

With these funds, Showa repaid its bank 160 billion yen for both long and short-term borrowing combined. Since its equipment investment during this period was 33.1 billion yen, Showa calculates that it allotted a little less than 80 percent of the funds raised from the capital market to the repayment of its borrowing. Indeed, it used a debt reduction strategy expressed in the following line: "Good bye, Mr. Bank. Hello, Mr. Securities."

Sumitomo Chemical Company, Limited also brought its financial income and expenditures (receipts of bank account interest and stock dividends, less such payments as interest on borrowing and bill discount charges) to a surplus in its December 1989 account settlement, for the first time in its history. Although President Hideo Mori says that "it just so happened that way last year," companies in the world of industry have diligently accommodated funds from the capital market and sought to improve their financial health.

Yet, there is now a sharp drop in stock prices. As of fiscal year 1989, the Tokyo Electric Power Company, Incorporated was planning a 1.2 trillion yen equipment investment. Although it plans to raise 400 billion yen at low cost through the capital market, an 80 billion yen unissued portion remains. The sluggish market is a headache for them—"We can't change the issue plan."

In addition, with the yen market even one yen cheaper, Tokyo Electric will sufffer a 4 billion yen exchange loss.

If the price of crude oil rises by $1, its fuel expenses will go up by 26 billion yen. Thus, cheap stock prices and the weak yen will hit Tokyo Electric as a double punch. Moreover, cheap bond prices will invite interest rates to rise, and will suppress income. The business environment will inevitably become more difficult.

On 27 [February] when the Tokyo stock price experienced violent fluctuations, Yamanouchi Pharmaceutical Co., Ltd. decided to cancel its planned issue of French franc-based warrant bonds. If the "cheap trio," namely cheap stock prices, the weak yen and cheap bond prices continue, such fundraising through stock issues by businesses will probably decline.

Of course, there are also quite a few enterprises which view the "cheap trio" calmly. The electric [equipment] manufacturing industry, which seeks the increase and strengthening of equipment for the semiconductor, "the rice of industry," states that "there cannot be an immediate reconsideration. We will just watch the situation" (Toshiba). Mr. Tsutomu Tanaka, the director general of the EconomicPlanning Agency's Research Bureau explains that "The foundation of business is firm. It is conceivable that the 'cheap trio' will soften the overheated impression of business, and function as an advantage from the aspect of continuation."

Nevertheless, if the unstable situation lasts long, it will turn into being a drag on business.

The [Japanese] government is expecting 4.0 percent real economic growth for the next fiscal year. The contribution of various factors to that growth is as follows: less foreign demand, 0.5 percent; personal spending, 2.5 percent; private equipment investment, 1.7 percent. Thus, expectations for equipment investment is as strong as ever. If such equipment investment stagnates because of the present "cheap trio," business will slow down by that much.

[1 Mar 90 p 8]

[Article by SANKEI economic section reporter Akio Ikehara]

[Text] **Surplus Reduction; Direct Foreign Investment Also Accelerates Weak Yen**

"After its peak in 1987, the balance on current account fell remarkably by over $30 billion to $57 billion last year. It is an evidence that structural adjustments, such as overseas production and the increase of product imports, are progressing favorably."

On the second day of the Third U.S.-Japan Structural Impediments Initiative [SII] conference held in Tokyo last week, the [Japanese] Ministry of Finance official in charge offered the above explanation when both parties exchanged opinions about the balance of international payments during a "break" in-between the fierce debates. In response, the U.S. side expressed its thoughts by saying, "That is good."

Yet, just as the Japanese current account surplus is beginning to fall, the "cheap trio" effect (the weak yen, cheap stock prices, and cheap bond prices), from the beginning of the week, has accelerated still further. The increasingly weak yen/strong dollar has especially weighed heavily as a dark cloud on the Japanese trade balance, which is about to be put on track for surplus reduction. An official of the International Finance Bureau in the Ministry of Finance said, "When I talked to a U.S. Treasury Department official on the phone, he sounded concerned"—the United States is getting increasingly anxious.

Although Japan's foreign trade statistics (customs clearance basis) for January reflected such factors as the [normal] seasonal decline in export activities, the amount of the surplus, which is the value of exports less the value of imports, was reduced by 89.5 percent compared to that of the same month last year. This is the largest percentage reduction since February 1984 when the trade balance turned positive. The month-to-month record has shown reductions over the same month in the previous year for nine months in a row since last May. It appears that the reduction of the trade surplus has taken firm root because of such factors as the decline in excesses available for export resulting from strong domestic consumption.

However, even after the third rise in interest rates, the gradually weakening yen is about to turn this trend backwards again. This is because one cannot deny the possibility of the weak yen improving the export competitiveness of Japanese products and again spurring on the export drives of businesses. If exports increase, the surplus will increase again.

Nevertheless, the reason why the trade surplus is not likely to increase right away is the fact that, during the period of the strong yen since the Plaza Accord of 1985, Japanese enterprises have built the structure to actively accommodate parts and materials from abroad, as a strong yen countermeasure. Even if the yen continues to weaken, overseas procurement will not decrease for some time. Also, the weak yen will lead to an increase in the amount of payments abroad.

Because of such circumstances, the Ministry of International Trade and Industry, which watches the export activities of enterprises closely, views the situation rather optimistically. A chief executive stated, "Considering the present trend of domestic business, as for now, it is difficult to think that Japan will shift back to an export orientation." Also, export-oriented manufacturers such as Mr. Atsushi Muramatsu, the vice president of Nissan Motor Co., Ltd. are saying that "there is no need to change the 'program of international cooperation' for reducing [Japanese] exports."

However, viewed from a different angle, there is some reason for concern. There remains the deep-rooted direct investment of many businesses, such as in building overseas plants.

Direct investment this fiscal year is as high as $60 billion-plus, an increase of approximately 30 percent compared to that during the last fiscal year. Businesses exchange yen for dollars and allot it to the investment. Therefore, "the pattern under which deep-rooted demand for dollars works as pressure toward a weak yen is not likely to change," opines one city bank dealer.

If the weak yen remains at a level which is over 150 yen to the dollar because of the above, it is inevitable that export pressure will be heightened. As a result, the key tone of the trade surplus reduction will change. Therefore, detrimental effects are inevitable with regard to the U.S.-Japan structural accord, which has arrived at its first important turning point, namely the putting together of an interim report. Along with this, the criticism against the surplus countries will again rise.

The confusion in financial and capital markets is beginning to cast a large shadow over the fields of trade and commerce as well.

[2 Mar 90 p 8]

[Article by SANKEI economic section reporter Tomoki Shigetani]

[Text] The "Weak" Yen; Changes in the Foundations of the Currency System

"Although they call it a 'strong dollar' and a 'weak yen,' in relative terms the dollar is falling. This means that the current yen is still weaker than that," points out Mr. Eishi Nakao, the manager of the exchange market section, the funds exchange market department of Nippon Credit Bank, Ltd. He stresses that one of the reasons for the change in the underlying tone of the foreign exchange market is the fact that the index showing the dollar value against all other currencies has now fallen by 10 percent, compared to September of last year.

The biggest reason for the depreciation of the dollar is the strong mark caused by increased prospects for the unification of East and West Germany. However, even the [West German] mark has a great chance of falling as the outlook increases that its exchange rate with the East German mark will be set at 1:1 under the plan for German monetary union. In other words, "there is no currency one can actively purchase any longer." Mr. Nakao has named it "the market of the elimination method." That is, whichever currency is left by the method of elimination is being purchased each time.

In such a market, the yen has become "the currency which gets crossed out first."

Although the Ministry of Finance and the Bank of Japan repeatedly stress that "there is no change in the fundamentals (various basic conditions of the economy)," the international financial market does not even take notice of the Japanese fundamentals. Under the circumstances, international financial analysts say, "Pay attention to the mark from now on," so the situation surrounding the yen and the dollar has completely changed as compared to a year ago.

According to one international finance source, the United States has begun to seriously worry about the weakness of the yen. Until just recently, there were some U.S. currency officials who even suggested that "For the prevention of inflation, it is good to have a strong dollar against the yen." Yet now they are said to be concerned that a strong dollar "will spoil the long-awaited direction toward elimination of the U.S.-Japan trade imbalance."

Mr. Pohl, the president of West German Bundesbank states that "the weak yen is Japan's fault for leaving interest rates low." This, too, is not a voice fearing the rebound of the yen in the market, but rather, one raised out of warning against the spread of an atmosphere which takes a weak yen for granted.

Although the Japanese inclination toward raising interest rates will be strengthened, there is yet a big gap with regard to European interest rates. Especially as the reduction of U.S. interest rates recedes from view, the yen is not in an environment to be purchased.

A dollar with a slightly smaller role as the key currency, a mark with an unclear chance for maintaining its strength as one views the future of East-West unification, and a weakening yen—the changes in the foundations of the international currency regime are, in effect, pressing for the reconstruction of the international system of cooperation. If the current situation is left alone, it will prolong the instability of the exchange markets, and may even discourage world business.